Canada-United States Trade Liberalization and Socio-Economic Integration: U.S. Perspectives

La libéralisation des échanges et l'intégration socio-économique nord-américaine : points de vue des États-Unis

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Papers presented at the conference of
l'Association Québécoise des Études Américaines,

Résumé détaillé des textes présentés au colloque de
l'Association Québécoise des Études Américaines,

les jeudi 30 et vendredi 31 octobre 1986.

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Avant-propos

L'angle sous lequel on envisage les choses est d'une grande importance pour la compréhension des relations économiques canado-américaines. Étant donné que l'économie canadienne est la plus petite des deux, les universitaires et analystes politiques de ce pays ont tendance à consacrer plus de temps que leurs collègues américains à l'examen de l'interaction entre les deux économies et entre les gouvernements situés de chaque côté du 49ème parallèle. Aussi les travaux de cette rencontre se distinguent-ils de ceux d'autres colloques sur les problèmes soulevés par les négociations de l'Accord de libre-échange, du fait qu'ils présentent le point de vue américain sur les questions majeures qui se posent dans les domaines économique, politique et culturel. Il est important que les Canadiens comprennent les réactions des Américains et leurs interprétations des faits, car la manière de voir de ces derniers diffère souvent de celle des Canadiens d'une manière subtile mais fondamentale.

Bien que les premières études présentées dans ce volume soient antérieures à l'achèvement des négociations sur le libre-échange, elles n'en demeurent pas moins pertinentes et permettent d'expliquer l'évolution des relations commerciales et politiques entre les deux économies. Certains domaines examinés, tel que celui des dépenses consacrées à la défense, n'ont pas été affectés par l'Accord de libre-échange, alors que pour d'autres les auteurs explorent l'impact sur la culture canadienne des politiques d'investissement des multinationales américaines, dans un cadre commercial bilatéral devenu plus libéral. Ces questions continuent à préoccuper les Canadiens, au fur et à mesure de la mise en vigueur de l'Accord. Par ailleurs, les auteurs analysent, au niveau gouvernemental du fédéral et des divers états américains, les transformations affectant la formulation des mesures économiques internationales prises par les États-Unis et qui continueront à influencer l'évolution des relations économiques entre nos deux pays. Cet

ouvrage offre donc des aperçus originaux et des perspectives exceptionnelles sur les relations complexes et interdépendantes qui existent entre les économies canadiennes et américaines et entre nos institutions politiques.

Les études publiées ici ont d'abord été présentées à l'occasion d'un colloque organisé par l'Association québécoise des études américaines. Pierre-Paul Proulx s'est chargé de la préparation de ce volume. Il a, en outre, rédigé un résumé détaillé des communications faites en français.

Rod Dobell
Président
L'Institut de recherches politiques

Foreword

Perspectives matter greatly in shaping understanding of Canada-U.S. economic relations. Since Canada is the smaller economy, Canadian scholars and policy analysts tend to devote more attention than their American colleagues to interaction between the two economies and between governments on each side of the 49th parallel. The proceedings of this conference are distinctive among the several which have addressed issues arising from the negotiations of the Free Trade Agreement with the United States. This conference registers American perspectives on the crucial economic, political and cultural issues. It is important for Canadians to understand American views and interpretations because often they differ from Canadian perspectives in subtle but crucial ways.

Although the initial papers in this volume were prepared prior to the completion of the negotiations of the Free Trade Agreement, the contributions are of continuing relevance to the evolution of commercial and political relations between the two economies. Some of the issues examined, such as defence spending, were not affected by the Free Trade Agreement while others probe the impact on Canadian culture and the investment decisions of U.S. multinational enterprises of freer bilateral trade—issues of continuing concern to Canadians as the implementation of the Free Trade Agreement proceeds. In addition, the authors review developments at the federal and state levels of government in the United States which influence the formulation of international economic policies in the United States and which will continue to shape the evolution of Canada-U.S. economic relations. This volume thus contributes some distinctive insights and unique perspectives on this complex interdependent relationship between the Canadian and U.S. economies and bodies politic.

The papers in this volume were first presented to a conference organized by l'Association Québécoise des Études Américaines. In addition to editing the present volume, Pierre-Paul Proulx has prepared a detailed summary of the papers presented in French.

Rod Dobell
President
The Institute for Research on Public Policy

Commentaires d'introduction

Pierre-Paul Proulx
Responsable du colloque

Le colloque avait pour but de faire connaître les perceptions qu'ont nos voisins du Sud de divers aspects de la libéralisation bilatérale du commerce entre le Canada et les États-Unis.

Les conférenciers ont traité des questions suivantes, portant toutes sur la libéralisation des échanges: aspects historiques; processus législatifs, administratifs et politiques tant du point de vue national que régional; le dossier culturel; la réaction des multinationales américaines en termes d'investissement direct étranger au Canada; et l'impact de la politique de la défense américaine sur le commerce et le développement industriel et régional.

Les écrits ci-joints d'experts américains en la matière *ajoutent des éléments d'information et d'analyse nouveaux aux éléments connus jusqu'à ce jour* concernant cette négociation fondamentale de la libéralisation des échanges entre le Canada et les États-Unis.

Ces experts étant américains ont choisi, et c'était convenu, de présenter leurs textes en anglais. Le colloque étant organisé par l'Association Québécoise des Études Américaines, dont la majorité des membres sont francophones, nous avons *préparé un résumé détaillé des textes qu'on retrouve dans la prochaine section de ce volume.*

Sauf erreur, on retrouve dans ce résumé détaillé *toute l'argumentation et les données principales utilisées par les auteurs.*

Les Francophones qui le désirent pouront donc lire ce résumé détaillé et être à l'aise qu'ils ont lu l'essentiel des textes publiés, et nos collèques Anglophones sont invités à en faires autant ou à lire les textes originaux.

Notons en guise d'introduction quelques-uns des aspects intéressants du problème traité par nos conférenciers.

Il sera intéressant de constater à l'hiver 1987-1988 si l'histoire se répète en ce qui concerne les relations bilatérales Canada/États-Unis, car selon *Earl Fry* le scénario a été répété à ce jour, à savoir: initiation des négociations par le Canada et ce en conjoncture économique difficile; indifférence des États-Unis (sauf en 1911); et obstacles posés par le Sénat. L'histoire a vu le Canada se retirer ou terminer les négociations et les États-Unis abroger le seul traité de Réciprocité qui ait existé depuis 1954. Anticipant du protectionnisme continu de la part des États-Unis et une situation où le Canada a beaucoup à perdre, Fry est d'avis qu'il est dans l'intérêt du Canada de négocier bilatéralement avec les États-Unis ainsi que multilatéralement, voie plus tortueuse et lente selon lui.

A. Erdilek, comme suite à sa revue de la théorie de l'investissement direct étranger et d'une enquête auprès de 28 maisons mères américaines ayant des succursales au Canada, dans laquelle il a tenté de cerner leurs réactions à la libéralisation en ce qui concerne leurs succursales, nous livre des conclusions et une analyse trop riches à résumer en introduction. Notons tout simplement qu'en conclusion générale, Erdilek est d'avis qu'il se produirait à court terme une augmentation relative des exportations des maisons mères vers le Canada par rapport à celles de leurs succursales canadiennes vers les États-Unis; à moyen-long terme, comme suite à une rationalisation des succursales qui s'intégreraient plus complètement au réseau nord-américain de la maison mère, Erdilek anticipe des résultats positifs sur les investissements au Canada et les exportations des succursales américaines implantées au Canada.

Les Feldman, quant à eux, font ressortir l'ampleur grandissante des activités des différents États sur la scène internationale, et partant de cette nouvelle réalité et du rôle important des Comités de la Chambre des Représentants et du Sénat, s'inquiètent des nombreuses voies négligées par les Canadiens dans les négociations actuelles. Selon eux, une attention particulière doit être donnée aux gouverneurs d'États et aux présidents et membres des puissants comités du Congrès, d'autant plus que le gouvernement fédéral américain aurait abandonné tout essai de faire valoir ses prérogatives constitutionnelles sur le commerce international, laissant le champ libre aux États.

Selon C. Doran, la fragilité culturelle réelle ou imaginée du Canada donne lieu à une situation où les gouvernements canadiens continuent et continueront de réglementer les interventions de l'extérieur dans le domaine culturel. Selon lui, les moyens utilisés pour défendre la souveraineté culturelle canadienne donnent souvent lieu à des effets contraires à l'objectif poursuivi, tout en accordant aux acteurs impliqués un protectionnisme rentable qui ne contribue en rien aux objectifs canadiens.

Quant à G.C. Hufbauer, il présente de façon synthétique et magistrale les multiples mécanismes et les nombreux acteurs impliqués dans la formulation et la

gestion de la politique commerciale américaine. Sa discussion de la protection contingente illustrée par le cas du bois d'oeuvre tombe à point et sa conclusion à l'effet qu'on peut au plus voir naître un organisme bilatéral qui ferait du "monitoring" et de la conciliation et qui comparaîtrait ex officio devant l'"International Trade Administration" du "Department of Commerce" et l'"International Trade Commission" sans pouvoirs d'arbitrage, devrait inciter les Canadiens à faire de la planification contingence au cas où il aurait raison. Il ne voit pas se produire la concentration désirée par les Canadiens selon laquelle le "United States Trade Representative" aurait un rôle important et prépondérant dans la politique commerciale, rejoignant en cela les Feldman qui voient un éclatement grandissant dans ce domaine aux Etats-Unis.

Son relevé de la petite histoire des ententes effectuées entre le Président et le Congrès nous apprend beaucoup concernant les bénéfices et coûts de la procédure accélérée (fast track) et les motifs d'imposition des droits sur les bardeaux de cèdre.

Ann Markusen traite d'une question souvent évoquée mais peu analysée par les Canadiens, à savoir l'utilisation de la politique de la défense américaine à des fins qui correspondent à celle poursuivie par les politiques industrielles et régionales du Canada; la politique de la défense étant intouchable par les négociations, les politiques domestiques canadiennes industrielles et régionales étant vues comme des mesures à limiter dans leur utilisation par les négociateurs américains.

Ann Markusen décrit de façon convaincante les impacts sectoriels et régionaux des dépenses du Pentagone et fait une analyse intéressante de l'impact de la libéralisation des échanges sur le Canada.

Selon Markusen, les effets des dépenses de la défense sur la localisation géographique aux États-Unis, e.g. du "heartland" industriel, du Midwest et des Grands Lacs, qui ressemblent à l'Ontario et au Québec vers la périmétrie de la défense qu'elle décrit clairement; et la mutation des dépenses *de l'industrie lourde* (acier, machines-outils . . .) vers la télématique (ordinateurs, logiciels, télécommunications, électronique . . .) auraient des *effets négatifs* sur la croissance des importations américaines provenant du Canada relativement à celles de l'Asie, suite à la libéralisation des échanges. Son examen de la composition des flux d'exportation du Canada vers les États-Unis indique que c'est dans les métaux, la machinerie, l'équipement de transport, plutôt que dans les domaines reliés à la défense et à la haute technologie, que les exportations canadiennes ont le plus augmenté. Dans les télécommunications, la part des importations américaines provenant du Canada a diminué. Notons cependant que le déplacement des entreprises canadiennes vers les États-Unis y est peut-être pour quelque chose.

Markusen ne croit pas que le Canada réussisse à faire libéraliser le commerce relié à la défense entre les deux pays. Elle suggère que les deux pays s'interrogent plutôt sur les raisons de leur pauvre performance sur le plan international dans les biens durables et les biens de production civile, stratégie que le Canada pourrait tenter d'explorer étant donné le fait que son "establishment" de R&D est moins axé (pour l'instant du moins) sur le matériel de la défense.

Les conférenciers, commentateurs et participants ont évoqué bon nombre de questions négligées et à peine abordées dans le débat sur la libéralisation des échanges. Nous osons espérer que la lecture de ces textes contribuera à leur identification et prise en considération sérieuse dans les négociations bilatérales et multilatérales qui impliqueront le Canada dans les mois et années qui viennent.

Concluons en remerciant sincèrement les organismes suivants qui ont contribué financièrement ou par leur prêt de personnel au colloque: l'Ambassade des États-Unis, Le ministère de l'Expansion Industrielle Régionale, le ministère des Relations Internationales du Québec, le ministère de l'Industrie et du Commerce du Québec, le ministère du Commerce Extérieur du Québec, l'Association des Étudiants du Département des Sciences Économiques de l'Université de Montréal et de l'U.Q.A.M.

Nos remerciements à l'Ambassadeur T. Niles pour son allocution au souper, à l'honorable Pierre McDonald pour sa conférence de clôture, à Monsieur Germain Denis du Bureau du Négociateur canadien pour son allocution au déjeûner.

Aux présidents de séance P.C. Dobell de l'I.R.P., Diane Bellemare de l'U.Q.A.M., Edmond Orban de l'Université de Montréal, Albert Desbiens de l'U.Q.A.M., Président de l'A.Q.E.A., Pierre Jolin du ministère des Relations Internationales, Alfred O. Hero de Louisiane et Rodrigue Tremblay de l'Université de Montréal, nos remerciements pour un colloque qui s'est bien déroulé sous leur direction.

Aux commentateurs Alfred Dubuc de l'U.Q.A.M., Bernard Bonin de l'E.N.A.P., Lise Bissonnette (au Devoir jusqu'au jour qui a précédé le colloque), Jacques Godbout, auteur et cinéaste de l'O.N.F., P. Soldatos de l'Université de Montréal et Paul Létourneau du Collège militaire de St-Jean, nos excuses de ne pas avoir publié le résumé de leurs propos, faute de ressources financières. Le succès de la conférence tient beaucoup à la qualité de leurs commentaires. La grande majorité des conférenciers se souviendra entre autres des propos de Jacques Godbout suite à l'allocution de Charles Doran et de l'approfondissement par Alfred Dubuc du survol historique des relations commerciales présenté par Earl Fry.

Nos remerciements aussi aux membres du *Comité consultatif* du colloque qui ont aidé à concevoir un colloque substantiel qui ajoute aux connaissances des Canadiens sur le sujet, à savoir: Lise Bissonnette, Albert Desbiens, Président de l'A.Q.E.A., Marcel Gaudreau, Direction des États-Unis au Ministère des Relations Internationales du Québec, Carl Grenier, Directeur de la politique commerciale au ministère du Commerce Extérieur et du Développement technologique du Québec, Yvon Pomerleau, Directeur des relations internationales au ministère de l'Industrie et du Commerce du Québec et P. Soldatos, Professeur en Sciences politiques et Président du Conseil Canadien des Affaires Européennes. En orientant le colloque vers les perceptions américaines sur la libéralisation, ils ont choisi un créneau peu exploité et très intéressant pour les Canadiens.

Merci au Conseil d'administration de l'A.Q.E.A. d'avoir accepté que le premier colloque de l'Association se tienne sur le thème de la libéralisation des échanges.

Espérons que la parution de ce volume aidera au rayonnement d'une jeune association qui a du pain sur la planche.

À l'Institut de recherches politiques qui a accepté de publier ce volume, nos sincères remerciements. Ce volume s'ajoute à une série de publications de l'I.R.P. qui contribuent chacune de façon substantielle à la discussion et à la mise au point de politiques publiques au Canada.

Introductory Comments

Pierre-Paul Proulx
Conference Organiser, Vice President of the A.Q.E.A.

The main purpose of the conference was to air U.S. opinions on chosen aspects of Canada–U.S. bilateral trade liberalization.

The conference speakers dealt with the following questions: historical aspects; legislative, administrative and political processes both nationally and regionally; cultural sovereignty and protectionism; the reactions of U.S. head offices in terms of rationalization and investment of the Canadian subsidiaries; and the effects of liberalization on defence expenditures, regional and industrial, and trade.

The papers presented *and new elements of analysis and information* concerning Canada–U.S. bilateral trade liberalization

Our American experts chose, and that was expected, to present their conferences and write their papers in English. We chose to prepare a detailed summary of their papers in French (see the next section) since the majority of the members of the Association Québécoise des Etudes Americaines are francophones.

Francophones unable to read in English or prefering to read in French can rest assured that they will be reading the essential arguments and information presented at the conference. Our anglophone colleagues are of course invited to read the summary in French.

Let us briefly indicate the nature of a few of the questions dealt with by our speakers.

It will be interesting to observe this winter (1987-1988) whether history will repeat itself in Canada–U.S. bilateral relations. According to *Earl Fry* the usual scenario has

already started unfolding for Canada initiated the negotiations, at a time of domestic economic problems; the U.S. has remained relatively indifferent (the usual pattern, except in 1911) and the Senate has posed problems and presented obstacles to Canadian proposals, as in the past. Whether Canada will terminate or withdraw from the negotiations as in the past, and whether the U.S. will abrogate unilaterally any treaty or agreement that might be negotiated as it did with the 1854 Treaty of Reciprocity remains to be seen.

Earl Fry suggests that Canada simultaneously pursue both the bilateral negotiations with the U.S. (it has a lot to lose because he anticipates further protectionism) and the slower, more tortuous multilateral trade liberalization route.

A. Erdilek reviews existing theory and studies of the effects of trade liberalization on foreign direct investments and presents the results of his survey of the reactins to trade liberalization of 28 head offices having subsidiaries in Canada.

We shall not attempt to summarize his extensive results here. His general conclusion is that head office exports to Canada would increase more than Canadian subsidiary exports to the U.S. in the short term, a process of rationalization and integration of the subsidiaries into the North American network setting in thereafter. The results of such a process will be beneficial in terms of investments in Canada and exports by American subsidiaries from Canada.

The *Feldman's* document notes the growing role of individual states in U.S. trade policy and emphasizes the importance of House and Senate Committees in trade negotiations. They suggest that Canadians should be communicating more with individual state governors and the presidents of powerful committees of Congress, especially since the U.S. federal government has given up attempts to have its preponderant jurisdiction in trade recognized.

According to *C. Doran* the actual or perceived fragility of Canadian culture is such that Canadian governments will continue to intervene in cultural matters. He maintains that many of the means used by Canadians to promote cultural sovereignty have exactly opposite results to those sought. In addition, he maintains that some measures utilized simply provide profitable protectionism to individuals and firms without promoting the attainment of Canadian cultural objectives. Jacques Godbout from the National Film Board responded with energy to Doran's observations. He pointed out the limited potential for Québec cultural products in the U.S. and noted that cultural protectionism in France and Belgium are of more interest to Québec than that in the U.S.

Gary Hufbauer's identification of the numerous actors and institutions involved in the formulation and management of U.S. trade policy is particularly relevant in that he illustrates the workings of U.S. contingent protection through his examination of the softwood lumber case. Most Canadian readers will learn from this American's perception of that case.

Hufbauer's conclusion that at most negotiations would give rise to a bilateral mechanism for monitoring and consultation with the possibility of appearing *ex officio* at International Trade Commission and ITA dumping and countervail cases should cause

Canadians to indulge in more contengency planning than is apparently the case. G. Hufbauer sees little likelihood of a centralization of responsibilities occuring in the hands of the U.S.T.R., joining in that the conclusion of the Feldmans who see growing diversity in U.S. trade actors and institutions.

Hufbauer's review of deals made between the President and congressional committees during the discussions leading to the close vote authorizing the fast track procedure (i.e. the imposition of duties on shakes and shingles) helps to assess the costs and benefits of the fast track procedure.

Ann Markusen's discussion of a question present in many Canadians minds, i.e. the use of defence expenditures to attain objectives pursued by Canadian industrial and regional policies, provides insights into a relatively neglected question relevant to the trade negotiations.

Markusen describes clearly sectoral and regional impacts of Pentagon expenditures and draws interesting inferences from her analysis concerning the impact of trade liberalization on Canada's exports to the U.S.

She makes a compelling case for an argument that defence expenditures have much to do with the geographic shift of economic activity from the industrial heartland (the Midwest and the Great Lakes) to a defence perimeter which she describes clearly. She also argues convincingly that defence expenditures have much to do with the decline of heavy industry (steel, machine tools, etc.) and the rise of high technology industries. She points out that *those regions and industries affected negatively resemble Ontario and Quebec* and concludes that trade liberalization would have a negative impact on Canadian exports to the U.S. relative to those of South East Asia.

Markusen's examination of trade flows between Canada and the U.S. indicates that it is in exports of metals, machinery, and transportation equipment rather than in defence related high technology products that Canada did relatively well. Canada's share of U.S. telecommunications imports also fell, although part of that result might be caused by the migration south of parts of Canada's telecommunications industry.

Markusen does not believe that Canada will succeed in efforts to liberalize defence related trade and suggests that both countries concentrate on understanding why they are losing ground in durable goods and civilian goods production. A strategy for Canada might be to focus on science and technology efforts relatively more on civilian applications rather than military applications as in the U.S.A.

The speakers, commentators and conference participants raised and discussed many neglected questions relevant to the ongoing negotiations. Let us hope that the publication of these papers will make for more serious consideration of some of them.

Sincere thanks to the organizations who provided financial support and personnel for the conference: the U.S. Embassy, D.R.I.E., the "Ministère des Relations Internationales du Québec", the "Ministère de l'Industrie et du Commerce du Québec", the "Ministère du Commerce Extérieur et du Developpement Technologique du Québec"

and the "Association des étudiants du département des sciences économiques de l'Université de Montréal".

Sincere thanks also to Ambassador T. Niles for his address at supper, to the Honourable Pierre MacDonald for his comments which closed the conference and to Germain Denis from the Canadian Trade Negotiator's Office for his address at lunch.

Our conference also proceeded efficiently under the presidency of P.C. Dobell from the I.R.P.P., Diane Bellemare from U.Q.A. M., Edmond Orban from the "Université de Montréal", Albert Desbiens from U.Q.A M., President of the A.Q.E.A., Pierre Jolin from the "Ministère des Relations Internationales", Alfred Hero from Louisiana and Rodrigue Tremblay from the "University de Montréal". To all of them, our gratitude.

Our commentators Alfred Dubuc from U.Q.A. M., Bernard Bonin from the E.N.A.P., Lise Bissonnette (formerly from "Le Devoir"), Jacques Godbout from the N.F.B., P. Soldatos from the "Université de Montréal" and Paul Létourneau from the Royal Military College also made for a lively and informative conference.

The choices made by our Conference Consultative Committee: Lise Bissonnette, Albert Desbiens, Marcel Gaudreau of the "Ministère des Relations Internatinales", Carl Grenier of the "Ministère du Commerce Extérieur", Yvon Pomerleau of the "Ministère de l'Industrie et du Commerce" and P. Soldatos of the "Université de Montréal" made for a conference which provided new and complementary views to other conferences on trade liberalization.

Thank you also to the Executive Council of the A.Q.E.A. for allowing the first A.Q.E.A. conference to deal with trade liberalization.

Finally, our gratitude to the I.R.P.P. for agreeing to publish this volume. It joins a series of I.R.P.P. publications, each of which contributes in a substantive way to the formulation of public policy in Canada.

Résumé détaillé des textes présentés à la Conférence

par

Pierre-Paul Proulx

Résumé détaillé

I. Earl Fry—Un bref aperçu historique des relations commerciales Canada/États-Unis

Earl Fry, Directeur des Études canadiennes à Brigham Young University, présente un survol de l'histoire des relations commerciales États-Unis/Canada et en tire des conclusions pour la ronde des négociations actuelles. Fry nous rappelle que de nombreux leaders américains et ce, dès 1775-1776, avaient comme objectifs de chasser l'Angleterre de l'Amérique du Nord et d'occuper le territoire canadien, soit par la force, soit sur invitation spéciale (article 11 de la première constitution des États-Unis).

Il décrit le contexte de la négociation qui a donné lieu au traité de réciprocité Elgin-Marcy de 1854 (abrogé par les États-Unis en 1866 unilatéralement) lequel portait surtout sur des biens primaires.

Selon Fry, l'expansionnisme américain (la Louisiane en 1803, la Floride, le Texas, certains territoires mexicains, l'Alaska) ne s'étendit pas au Canada car les Américains étaient fatigués de la guerre, endettés et préoccupés par les problèmes économiques et politiques internes. De plus, les racines anglo-saxonnes communes des Américains et des Canadiens expliqueraient aussi l'acceptation par les Américains du Canada comme pays indépendant.

Fry décrit les négociations, initiées comme toujours par les Canadiens, qui donnèrent lieu à un deuxième projet de traité de libéralisation en 187[illegible]. Ce traité fut approuvé par le Parlement d'Angleterre pour le Canada mais refusé par le Sénat américain.

Cette absence d'intérêt de la part des Américains, une autre constante dans l'histoire des relations bilatérales Canada/États-Unis, fut en partie responsable de la politique nationale à hauts tarifs de Sir John A. MacDonald.

Le parti libéral canadien fut le champion de la libéralisation des échanges en 1891 (il fut battu par MacDonald) et à nouveau en 1911 alors que Wilfrid Laurier présenta à la Chambre des Communes un projet semblable à celui de 1854 selon lequel presque tous les tarifs américains sur les biens du secteur secondaire étaient abolis, ceux du Canada demeurant en place. On excluait l'Angleterre du processus d'approbation et les États-Unis auraient approuvé le projet sans un vote aux deux tiers du Sénat (méthode de la voie accélérée — fast track). En juillet 1911, à la suite de l'approbation des deux chambres du Congrès, le Président Taft (qui avait passé une partie de 38 étés à Murray Bay) signa l'entente. Au Canada, Laurier fût défait par Borden et le nouveau parti conservateur ne présenta pas le Traité de Réciprocité en chambre pour fins de vote.

Fry décrit explicitement les effets aux États-Unis de la dépression et du tarif Smoot-Hawley de 1930, lequel augmenta les tarifs moyens américains jusqu'à 59%, ayant pour effet de faire tomber les importations de 1932 au niveau de celles de 1909. À la suite du "Buy American Act" de 1933 et des représailles des autres pays, le chômage américain monta à 25% et le revenu réel per capita retomba à son niveau de 1907.

L'arrivée de Roosevelt à la Maison Blanche en 1933 et le "Trade Agreements Act" de 1934 (Hull Act) habilitèrent le Président à convenir d'ententes bilatérales donnant lieu à des coupures tarifaires allant jusqu'à 50%. Deux ententes furent convenues avec le Canada, une en 1935, l'autre en 1938.

Fry évoque les ententes bilatérales de 1940 (Ogdensburg) et 1941 (Hyde Park), lesquelles préparèrent la voie pour le Pacte de la défense, et signale qu'en 1944, les tarifs sur les machineries et pièces agricoles furent enlevés.

En 1947 et 1948, King et Truman commencèrent des négociations privées auxquelles King mit fin subitement en mai 1948.

La participation au GATT et le Pacte de l'auto de janvier 1965 permirent de libéraliser le commerce Canada/États-Unis dans l'après-guerre.

Suivirent une dizaine d'années durant lesquelles la relation se détériora. Fry note les événements suivants pour documenter cette détérioration: en 1971, la surtaxe Nixon de 10% sur toutes les importations de laquelle le Canada ne fut pas exempté; la troisième option de 1972 selon laquelle le Canada cherchait à diversifier ses relations commerciales et ses investissements étrangers; l'Agence canadienne de Tamisage des Investissements (FIRA) de 1973; la "canadianisation" de Time et Reader's Digest; la Politique nationale de l'Énergie de 1981; et du côté des États-Unis, la non-déductibilité pour fins d'impôts américains des frais de conférences tenues au Canada; et l'imposition de droits compensatoires américains, en février 1979, sur les importations de systèmes optiques Honeywell produits au Canada.

Selon Fry, le Canada se tourne vers l'extérieur lorsqu'il fait face à des problèmes domestiques, ce qui donna lieu à un renversement de politique par le gouvernement Trudeau, lequel amenuisa les contraintes de la PNE et de l'Agence de Tamisage des Investissements. Ce fut la période des négociations bilatérales sectorielles, suivie par l'initiative du nouveau gouvernement conservateur de Brian Mulroney visant la négociation d'un accord global et bilatéral de libéralisation.

La chronologie des événements telle que présentée par Fry fait ressortir les phénomènes suivants:

1) le Canada a toujours initié les discussions;

2) exception faite de l'intérêt de Taft en 1911, les États-Unis ont, en règle générale, été assez indifférents devant une telle initiative;

3) une fois les négociations amorcées, le Canada s'en est retiré et a terminé les négociations;

4) le Sénat canadien pose toujours des obstacles sérieux;

5) les États-Unis abrogèrent le seul traité de réciprocité qui ait existé, celui de 1854;

6) lorsque l'économie se détériore, le Canada tente de favoriser son accès au marché américain, alors que les États-Unis deviennent protectionnistes.

Fry tire des parallèles entre les négociations actuelles et celles du passé. Selon lui, les soucis canadiens sur le plan culturel et de la souveraineté politique, la portée limitée de l'entente possible, l'indifférence des États-Unis, l'intérêt réel mais moindre que celui de Taft présenté par Reagan, peuvent mettre fin aux négociations. Selon Fry, la procédure de la voie accélérée (fast track), utilisée initialement en 1985 pour ratifier l'entente États-Unis/Canada, pourrait cependant aider à faire passer une entente.

Fry maintient que le Canada risque effectivement de perdre une partie de ses marchés américains à cause des sérieuses difficultés économiques aux États-Unis et du protectionnisme qui les accompagnent. Il indique que les deux pays peuvent gagner ou perdre selon l'aboutissement des négociations, le Canada ayant plus à gagner et à perdre.

La dépendance canadienne du marché américain pour l'écoulement de ses produits manufacturés, et, selon Fry, le fait qu'une nouvelle troisième option visant au commerce accru avec l'Europe et l'Asie impliquerait des biens du secteur primaire, indiquent toute l'importance d'une entente bilatérale avec les États-Unis, laquelle ne serait pas incompatible avec la diversification des relations commerciales du Canada.

Selon Fry, la voie multilatérale du GATT, quoique moins dangereuse pour le Canada, sera lente à aboutir et ne donnera lieu qu'à des résultats marginaux dans des domaines importants pour le Canada, à savoir les questions agricoles, les services, les subventions, les investissements, les marchés publics et la propriété intellectuelle.

Écrivant en octobre 1986, Fry anticipe d'autres mesures protectionnistes de la part des États-Unis visant des secteurs autres que le bardeau de cèdres et le bois mou. Il conclut que l'histoire est pleine de leçons pour les négociateurs actuels, constat qui fut amplement illustré par le commentateur de son texte, A. Dubuc, et les propos des autres conférenciers et participants au colloque.

Résumé détaillé

II. Asim Erdilek—L'impact de la libéralisation des échanges sur l'investissement direct américain au Canada

Le professeur Asim Erdilek a traité de l'impact potentiel de la libéralisation bilatérale des échanges sur l'investissement direct américain dans le secteur manufacturier du Canada.

Erdilek note qu'en 1979, le Congrès avait exigé du président qu'il explore la possibilité d'une entente de libre-échange avec le Canada dans le cadre du "Trade Agreement Act" de 1979. Il note que le "Trade and Tariff Act" de 1984 a donné au Président des États-Unis un mandat explicite de négocier une zone de libre-échange avec le Canada ainsi qu'avec d'autres pays. Il note que les barrières non tarifaires posent beaucoup plus de problèmes que les tarifs et signale qu'en janvier 1987, plus de 80% des exportations canadiennes vers les États-Unis et 60% des exportations américaines vers le Canada seront en franchise, suite au Tokyo Round du GATT. Il signale qu'en 1987, les tarifs canadiens et américains sur les produits manufacturés seraient en moyenne de 9 à 10% d'une part et de 4 à 5% d'autre part, certains tarifs demeurant cependant assez élevés.

Erdilek examine ensuite l'ampleur des relations bilatérales dans le domaine commercial et de l'investissement direct dans le secteur secondaire. Il note que le Canada est responsable de 25% des exportations totales des États-Unis et de 19% de leurs importations, alors que les États-Unis reçoivent 79% des exportations canadiennes et que c'est des États-Unis que proviennent 72% des importations canadiennes. Notons que cette dépendance canadienne du marché américain est atypique et reflète le rôle moteur de l'économie mondiale qu'a joué l'économie américaine durant les années 1980. Un rôle accru de la part de l'Allemagne de l'ouest ou du Japon et une récession américaine donneront lieu à un potentiel de diversification des relations commerciales canadiennes, d'autant plus que la dévaluation du dollar canadien, suivant en cela le dollar américain,

donnera lieu aussi à une certaine possibilité de diversification des exportations canadiennes.

Erdilek signale que l'importance des flux bilatéraux de commerce, un souci quant à l'accès continu au marché américain et un désir d'améliorer la compétitivité internationale du secteur secondaire canadien, sont à la source de l'initiative des discussions bilatérales de la part du Canada.

Erdilek signale que durant la période de 1980 à 1985, la part canadienne des exportations de produits secondaires des États-Unis est passée de 18 à 26%, alors que sa part des importations américaines de produits importés est passée de 16 à 19%. Les produits du secteur de l'automobile ont été en moyenne 36% des exportations bilatérales américaines et 47% de ses importations bilatérales. La balance commerciale bilatérale a été en faveur du Canada pour l'ensemble du secteur secondaire et pour les produits du secteur de l'auto depuis 1982. Les États-Unis maintiennent cependant une balance commerciale bilatérale favorable en ce qui concerne les produits de haute technologie depuis 1980. Ceux-ci ont été en moyenne 17% des exportations bilatérales du secteur secondaire et 10% des importations bilatérales secondaires des États-Unis.

Il note qu'une part majeure des exportations américaines du secteur de l'auto, à savoir les pièces automobiles, retournent aux États-Unis en tant qu'importation après avoir été assemblées au Canada surtout par les succursales de maisons mères américaines.

Erdilek signale que l'investissement direct étranger accompagné d'un pouvoir de gestion, contrairement à l'investissement de porte-feuille, implique non seulement des mouvements de capital financier mais aussi des mouvements intra-entreprises de capital physiq e et de ressources non financières telles que la technologie et la gestion. Il passe en revue l'examen des flux d'investissement impliquant les États-Unis et indique que, depuis 1980, les flux d'investissements directs étrangers sortant des États-Unis ont peu augmenté, alors que les flux vers les États-Unis ont augmenté de façon importante. Le contraire se serait produit au Canada depuis 1975. Aux États-Unis, le ratio des flux sortants d'investissements directs étrangers sur les flux entrants d'investissements directs étrangers est passé de 4.22 en 1977 à 2.60 en 1980 à 1.27 en 1985. Au Canada ce ratio serait passé de 0.34 en 1978 à 0.49 en 1981 à 0.50 en 1984. Chiffres à l'appui, Erdilek nous fait constater qu'en termes d'investissements directs étrangers, les États-Unis sont la principale source et la principale destination des investissements directs canadiens, alors que le Canada est la principale destination des investissements directs américains. Il examine aussi le déclin dans le contrôle étranger du secteur secondaire canadien. Son analyse nous fait constater que les parts du secteur secondaire dans l'investissement direct des Américains allant ou provenant du Canada sont plus basses que leurs parts dans le commerce entre les deux pays. Ceci résulte du fait que le commerce est plus facile du côté des biens manufacturés que du côté des biens non manufacturés, dont les services.

Erdilek examine ensuite les relations entre les flux de commerce et d'investissements directs étrangers bilatéraux. Il signale que le commerce bilatéral est fortement relié aux activités des investissements directs étrangers, surtout de la part des

firmes multinationales américaines ayant des installations de production des deux côtés de la frontière. Erdilek nous signale que, quoique la part des États-Unis dans les exportations mondiales ait diminué, la part des firmes multinationales américaines a été stable. En 1982, le Canada reçu 17% des exportations totales des firmes multinatinales américaines versus 16% de l'ensemble des exportations américaines, chiffre en déclin par rapport à la situation en 1977, alors que le Canada reçut 23% et 21% respectivement des États-Unis. Erdilek nous signale que 56% des exportations des firmes multinationales américaines vers le Canada le furent par l'entremise de leurs succursales. Il s'agirait en bonne partie d'un résultat attribuable aux exportations par la maison mère de véhicules et pièces automobiles pour fin de vente ou de transformation ou d'assemblage par leurs succursales canadiennes.

Si on examine les données sur les exportations des firmes multinationales américaines à leurs filiales canadiennes à propriété majoritaire (MOFA–majority-owned foreign affiliates), on constate que les véhicules, moteur et pièces, sont responsables de 58% de l'ensemble des exportations des firmes multinationales à propriété majoritaire en 1982. La part canadienne de l'ensemble des exportations américaines de véhicules, moteur et pièces, des firmes multinationales américaines vers leur succursale canadienne à propriété majoritaire est de 84%.

En 1982, le Canada était à l'origine de 42% de l'ensemble des importations américaines provenant de firmes affiliées. Erdilek nous signale que les ventes des succursales canadiennes détenues majoritairement par les maisons mères américaines ont consisté beaucoup plus en produits manufacturés que ce fut le cas pour les succursales américaines des autres pays. On voit encore là poindre l'importance du secteur de l'auto. Erdilek nous signale que les succursales canadiennes à propriété majoritaire américaine étaient deux fois plus dépendantes sur leurs exportations vers les États-Unis que c'est le cas pour l'ensemble des succursales à propriété étrangère majoritaire. Il note que le commerce impliquant les firmes multinationales américaines au Canada est substantiel et domine le commerce bilatéral dans le secteur secondaire. Ce facteur fait ressortir l'importance des décisions des maisons mères américaines quant au processus et à la nature de l'adaptation qui sera vécue au Canada suite à la libéralisation des échanges.

Erdilek passe ensuite en revue la théorie et les études empiriques concernant l'impact d'une libéralisation bilatérale Canada/États-Unis des échanges sur l'investissement direct américain dans le secteur manufacturier canadien. Il signale le fait qu'on ne connait pas les exceptions temporaires ou permanentes qui affecteront directement ou indirectement les flux de biens et services, et le fait qu'on ignore la durée de la période de transition qui sera négociée, facteurs qui rendent difficile l'estimation de l'impact de la libéralisation des échanges sur les flux d'investissements directs étrangers. Erdilek est aussi d'avis qu'il serait erroné de généraliser à partir des expériences du pacte de l'auto ou du pacte de la défense.

Erdilek choisit de ne pas examiner les arguments nationalistes selon lesquels l'investissement direct étranger américain augmenterait tellement au Canada qu'il y aurait absorption politique.

Il examine deux arguments assez opposés commençant par l'argument des pessimistes selon lequel le commerce et l'investissement direct étranger dans le secteur manufacturier sont des substituts. Selon cet argument, la cause principale de l'investissement direct étranger dans le secteur manufacturier est attribuable au protectionnisme et à la substitution aux importations dans le pays hôte. Selon cet argument, les succursales sont des répliques miniatures et innefficaces établies pour desservir le marché local. Advenant une zone de libre-échange de la fin du protectionnisme, il n'y aurait pas de motif de la part des maisons mères de maintenir leurs succursales de ce genre. Il passe en revue les écrits de Chisholm, selon lesquels l'investissement direct étranger dans le secteur des ressources naturelles n'est pas motivé par le protectionnisme et ne serait pas affecté adversement par une zone de libre-échange. Par contre, beaucoup de l'intégration horizontale dans le secteur manufacturier est dûe au protectionnisme canadien. Dans ce cas-là, il y aurait des effets négatifs provenant d'une zone de libre-échange. Les succursales seraient fermées à moins d'être rationalisées ou d'obtenir un mandat exclusif de production. La rationalisation transforme l'intégration verticale en augmentant le rôle de la succursale et en la spécialisant. Après la rationalisation, la succursale devient concurrentielle sur le plan international et orientée vers les exportations. Selon Chisholm, le potentiel pour une rationalisation et l'obtention de mandats exclusifs de production étant restreints, en partie à cause du manque d'initiative des gestionnaires canadiens, il faudra s'attendre à des résultats négatifs. Selon Erdilek, la faiblesse de l'argumentation de Chisholm tient au fait qu'il ne distingue pas entre les divers secteurs au sein de l'industrie secondaire et d'autre part ne tient pas compte des tailles très différentes des firmes multinationales ayant des stratégies différenciées.

Erdilek passe aussi en revue l'argumentation de Baranson selon laquelle les maisons mères américaines, advenant une zone de libre-échange, fermeraient leurs succursales canadiennes, d'une part car elles sont à 30% moins efficaces que leurs établissements américains, mais aussi parce qu'elles veulent former des complexes de fabrication flexible dans le mid-ouest et le sud des États-Unis où la main d'oeuvre est moins coûteuse et plus enclin à adapter les technologies nouvelles qu'au Canada. Selon Baranson, les succursales dans la fabrication de métal, la construction de machines, l'électrique et l'électronique, subiraient des effets négatifs car ce sont les facteurs où les applications de CAO/FAO et de production flexible sont les plus avancées aux États-Unis. Erdilek reproche à Baranson l'absence de vérification empirique de ses énoncés. Selon lui, les effets des nouvelles technologies CAO/FAO et de production flexible sur la localisation de la production ne sont pas établis.

Erdilek nous fait aussi état d'un des résultats provenant de son enquête effectuée pour les fins de ce colloque. Selon lui, beaucoup des succursales américaines seraient dans une situation plus difficile sans une zone de libre-échange qu'avec une zone de libre-échange.

Selon Erdilek, les arguments théoriques des optimistes qui envisagent le commerce et l'investissement direct étranger comme étant des compléments plutôt que des substituts sont plus acceptables que ceux des pessimistes. Erdilek examine les arguments de Markusen, selon lesquels des économies techniques internes spécifiques à l'entreprise ayant des établissements multiples (économies dues par exemple à une

innovation dont l'impact sur les établissements ne dépend pas du nombre d'établissements) peut donner lieu à une situation où il y a commerce *et* investissements directs étrangers simultanément. Cette complémentarité découle aussi en régime de libre-échange d'un modèle d'équilibre général de Helpman et Krugman, surtout lorsqu'il y a intégration verticale. Les firmes transnationales, dans ce cas, créent du commerce intra-industrie et intra-firme ainsi que du commerce inter-industrie. D'autre part, selon la théorie éclectique de Dunning, même dans un monde sans protectionnisme, il nous faudrait anticiper que la firme transnationale et l'investissement direct étranger continuent de coexister. La firme transnationale permet d'internaliser certains des risques économiques et politiques plus élevés dûs par exemple à la volatilité des taux de change. Selon l'argumentation des optimistes, la maison mère pourrait fermer certaines succursales mais elle tenterait initialement de les rationaliser, suite à l'établissement d'une zone de libre-échange. Les succursales deviendraient plus intégrées avec la maison mère, et axées sur les exportations, elles gagneraient en efficacité et en compétitivité. Une zone de libre-échange donnerait donc lieu à une augmentation dans l'investissement direct étranger et à une augmentation dans le commerce intra-firme transnational. Selon Erdilek, si la grande majorité des succursales étaient inefficaces sous un régime de protection et ne pouvaient être rationalisées, la fermeture donnerait lieu à un bénéfice d'adaptation des ressources au Canada. Il tire cette conclusion de la théorie du "immeserizing foreign investment" selon laquelle un pays qui attire de l'investissement direct étranger par la protection tarifaire peut subir une diminution de bien-être.

Erdilek souligne les résultats de Daly et MacCharles, lesquels dans une étude de 1982 d'un échantillon de 15 succursales américaines et 15 compagnies à propriété canadienne, ont estimé que les succursales sont mieux placées que leur contrepartie canadienne pour s'adapter et profiter de la libéralisation des échanges. Selon Daly et MacCharles, le protectionnisme canadien et les lacunes des gestionnaires canadiens sont principalement responsables de la basse productivité et des coûts élevés au Canada. Ils maintiennent qu'une augmentation dans les économies d'échelle et une spécialisation permise par une exportation accrue aux États-Unis sont très importantes.

Selon Burgess, l'effet statique à court terme d'une libéralisation des échanges pourrait être de faire transférer l'investissement direct étranger du secteur secondaire vers le secteur primaire et des services. Selon lui, l'effet dynamique serait positif sur l'investissement direct étranger. Selon Burgess, on ne peut cependant démontrer à priori l'impact de la libéralisation des échanges sur l'investissement direct étranger puisqu'il s'agit d'une gestion empirique.

Selon Erdilek, la Commission MacDonald prévoit qu'il y aurait un déclin possible de l'investissement direct étranger dans les pneus et les équipements médicaux, mais conclut que l'effet global serait positif.

Rugman, partant de sa théorie de l'internalisation, laquelle explique l'investissement direct étranger de la part des multinationales comme une réaction efficace à des coûts de transactions exogènes, rejette les arguments du groupe des pessimistes comme étant trop préoccupés par le protectionnisme comme déterminant de l'investissement direct étranger. Il met en lumière l'importance croissante du commerce intra-industrie définie par Erdilek comme étant: les flux bi-directionnels

d'investissements directs étrangers par les entreprises multinationales établies dans divers pays dans chacun de leurs marchés respectifs afin de produire des biens et services qui sont des substituts, soit pour fin de consommation ou de production et donc dans le même secteur. Selon Rugman, une zone de libre-échange va renforcer l'intégration économique déjà atteinte par les firmes multinationales en renforçant le continentalisme nord-américain. Selon Rugman, les coûts d'ajustements seraient subis surtout par les firmes transnationales. Rugman cite l'expérience d'intégration économique européenne où le commerce et l'investissement direct étranger ont été un élément moteur. Quoiqu'optimiste, et selon Erdilek trop optimiste puisqu'il n'a pas vérifié ses énoncés, Rugman est d'avis qu'il faut demander aux responsables de la planification stratégique des firmes transnationales quelle serait leur réaction advenant la libéralisation des échanges.

Wolf s'interroge sur la façon de générer les résultats empiriques pour vérifier la réaction des firmes transnationales à la libéralisation des échanges. Il identifie quatre méthodes: 1) enquête auprès de gestionnaires de la maison mère et de la succursale concernant leurs intentions, 2) un examen de la réaction des firmes transnationales américaines lorsqu'il y a eu libéralisation des échanges précédemment, 3) un examen des réactions de firmes transnationales américaines et non-américaines dans la CEE, et 4) des études économiques. Selon Wolf et selon la première démarche, on demanderait aux gestionnaires des firmes transnationales d'indiquer s'ils tenteraient de maintenir le statu quo, de rationaliser leurs succursales, d'octroyer des mandats exclusifs de production ou de fermer leurs succursales advenant la libéralisation des échanges. Ce sont les questions qu'Erdilek a posées dans son enquête auprès des 28 maisons mères américaines.

L'examen que Wolf a fait de l'adaptation des succursales américaines au Canada au processus de libéralisation des échanges du GATT dans l'après-guerre l'incite à y voir des effets positifs sur l'investissement.

Passant en revue les résultats négatifs sur l'investissement provenant des estimations de Brown et Stern, Erdilek fait ressortir qu'on ne peut distinguer entre l'investissement direct de porte-feuille et l'investissement direct comportant le contrôle, ou d'autre part entre investissement direct brut et investissement direct net dans chacun des secteurs. Il signale que dans leur modèle à court terme, les flux de capitaux internationaux intra-sectoriels sont nets versus bruts et il s'agit d'une ré-allocation qui se produit une fois sans qu'on puisse distinguer la nationalité des propriétaires impliqués. Les économies d'échelle étant ignorées dans ce modèle, la rationalisation des succursales ne se présente pas.

En conclusion, et partant de son examen des écrits, Erdilek conclut que l'efficacité de la grande majorité des succursales canadiennes serait améliorée suite à la libéralisation des échanges soit via la rationalisation ou l'obtention d'un mandat exclusif de production. Elles deviendraient mieux intégrées et plus interdépendantes avec leurs parents américains. Deuxièmement, la plus grande efficacité des succursales inciterait les parents à augmenter la taille de leurs opérations canadiennes. Il y aurait aussi des flux d'investissements directs étrangers de l'extérieur des États-Unis vers le Canada et il cite en exemple les résultats du secteur de l'automobile suite au pacte de l'auto. Il doute

cependant que les États-Unis acceptent des modalités comme celles qu'on retrouve dans le pacte de l'auto concernant le contenu local et des rapports production/vente et l'utilisation de critères de performance pour l'investissement direct provenant de l'étranger. Il croit en particulier que le programme canadien de remise de douane serait sujet à révision lors de la libéralisation des échanges.

Erdilek nous livre ensuite les résultats d'une enquête qu'il a effectuée auprès de 28 maisons mères américaines ayant des succursales au Canada. À chacune il a posé quatre questions:

1. Quel serait l'effet d'une zone de libre-échange sur le flux de biens et services entre votre maison mère et votre succursale canadienne?

2. Comment changeriez-vous la taille et la structure de votre succursale canadienne à la suite d'une zone de libre-échange?

3. Quelles politiques canadiennes et américaines, fédérales-provinciales ou des États, vous inciteraient à changer la taille et la structure de votre succursale canadienne?

4. Quel changement désireriez-vous dans les politiques canadiennes fédérales et provinciales concernant les investisseurs américains, suite à l'établissement d'une zone de libre-échange?

Erdilek note que les résultats obtenus sont qualitatifs et reflètent les points de vue subjectifs des présidents et vice-présidents des opérations internationales des firmes transnationales impliquées. Certains de ces dirigeants ont noté que leurs autres collègues dans la maison mère, et que les officiers de la succursale canadienne, pourraient différer d'eux dans leurs points de vue sur certaines questions.

L'échantillonnage des entreprises n'est pas statistiquement construit et se veut plutôt subjectif que représentatif. On y trouve cependant des grandes maisons mères produisant des biens de capital, des produits métalliques, des matériaux de construction, du papier, des produits chimiques divers, des peintures, des plastiques, des pneus, des biens durables pour fin de consommation et des biens non durables pour fin de consommation. L'industrie de l'auto a été exclue.

En ce qui concerne les exportations de biens et services, les répondants ont indiqué que, puisque les tarifs canadiens étaient, en règle générale, supérieurs à ceux des tarifs américains et que les prix canadiens étaient, en règle générale, au-dessus des prix américains, *la libéralisation bilatérale stimulerait les exportations bilatérales intra-firmes et inter-firmes de la maison mère plus que celles des succursales*. Les répondants ont noté cependant l'importance et le rôle des coûts d'expédition, de la différenciation des produits, les services locaux exigés par certains marchés, des politiques d'achat gouvernementales, des subventions gouvernementales pour la production locale et les exportations et du taux de change flexible comme facteurs importants. Certains ont noté qu'il pourrait y avoir un impact sur le coût unitaire relatif et donc un effet indirect sur le prix relatif des "intrants" canadiens et américains. Une exception fut dans le cas où une maison mère avait donné à sa succursale canadienne un mandat exclusif de production pour la fabrication de

comptoirs pour terminaux aériens. L'élimination du tarif américain dans ce cas augmenterait les exportations de la succursale canadienne vers les États-Unis. Une autre exception fut dans le domaine des "engineering fasteners" (nuts and bolts). On a signalé que les exportations de produits intermédiaires des maisons mères seraient stimulées plus que leurs exportations de produits finis. On pourrait vouloir compléter certaines lignes de biens durables pour le consommateur par des exportations provenant de maisons mères. On signale que l'impact positif sur les exportations des maisons mères diminuerait avec le temps, avec la restructuration et la rationalisation, et possiblement au profit des succursales.

Presque tous les répondants ont signalé l'importance du taux de change concernant leurs décisions commerciales et leurs décisions d'investissement. Un consensus se dégageait à l'effet que la valeur moindre du dollar canadien présentement reflétait les différentiels dans la productivité canadienne plutôt qu'une manipulation du taux de change par les autorités canadiennes. Il n'y a que les manufacturiers, dans le domaine des ressources naturelles et du fer, qui se sont plaints du taux de change actuel et qui ont critiqué la zone de libre-échange dans l'échantillonnage d'Erdilek. Du côté des pneus, on a fait une distinction nette entre les succursales couvertes par le pacte de l'auto et produisant des pneus originaux et les autres succursales sous optimales produisant seulement aux fins de remplacement. Ces dernières auraient plus de difficulté mais seraient éventuellement rationalisées pour devenir compétitives sur le plan nord-américain.

En ce qui concerne la taille et la structure des opérations canadiennes, on a confirmé qu'on la considère trop petite, trop vieille, qu'il y a trop de diversificatin dans les lignes de production. On a aussi considéré que les coûts unitaires étaient trop élevés et la qualité plus basse que dans les établissements aux États-Unis. Plusieurs des répondants indiquent avoir déjà commencé à rationaliser leurs succursales canadiennes. On signale que la situation canadienne est attribuable aux tarifs et aux barrières non-tarifaires qui ont empêché une intégration nord-américaine des opérations de ces firmes trans-nationales. Certaines exceptions se sont manifestées où il n'y avait pas d'écart, de taille ni de qualité entre les établissements américains et canadiens. Ceux-ci étaient caractérisés par un besoin d'être près de leurs clients à cause de l'importance des coûts d'expédition, des coûts locaux et du service après vente. Ceux-ci ré-arrangeraient cependant leur méthode de distribution et ajusteraient leurs lignes de produits et la localisation de leurs centres à la lumière d'une zone de libre-échange. D'autres répondants ont signalé que des producteurs canadiens de "ball bearings", de "metal stampings" et "washers" étaient très compétitifs et profiteraient de la zone de libre-échange. Ceux qui ont manifesté une réaction positive utilisaient de l'acier canadien et des "intrants" forestiers canadiens. Un répondant était ambivalent ou opposé à une zone de libre-échange, étant soucieux de la concurrence additionnelle canadienne qui en découlerait.

Un manufacturier de produits industriels pour le consommateur dans le secteur électrique était assez pessimiste concernant les effets sur les succursales canadiennes. L'utilisation de CAO/FAO et de production flexible dans l'établissement américain a rendu l'établissement canadien moins compétitif globalement, malgré les coûts de main-d'oeuvre et d'énergie plus bas que ceux de l'établissement américain. Il a indiqué qu'on

fermerait la succursale canadienne à moins de pouvoir l'orienter vers des items très spécialisés à bas volume. Dans le domaine des "major appliances", on voit soit des fermetures ou une rationalisation impliquant l'utilisation de nouvelles technologies et le congédiement de 20 à 30% des employés canadiens. Cette rationalisation réduirait l'importance des économies d'échelle, réduirait les coûts de main-d'oeuvre, augmenterait la qualité des modèles dont la production ne peut être faite qu'avec les équipements automatisés. On pourrait cependant attribuer à la succursale canadienne certains produits de niches particulières.

En ce qui concerne les politiques, plusieurs des répondants étaient d'avis qu'advenant une zone de libre-échange, les politiques d'achat et politiques préférentielles telles "Buy Canada" et "Buy America", fédérales et provinciales, devraient disparaître. On signale un contexte réglementaire plus exigeant au Canada qu'aux États-Unis, et en règle générale on signale que les autres politiques de subventions et d'impôts, soit fédérales soit provinciales, ne sont que d'importance secondaire quant aux décisions de localisation de la production. Un répondant dans la production de biens de consommation non durables a cependant signalé qu'il y aurait beaucoup d'harmonisation de politiques à effectuer dans le domaine des transports et dans le domaine du soutien et de la sécurité du revenu. Les producteurs de gros appareils électriques ménagers voulaient l'harmonisation des normes du "Canadian Standards Association" et du "Underwriters Laboratories". Plusieurs répondants manifestèrent leur opposition à des subventions et, selon Erdilek, plusieurs se sont plaints du taux de syndicalisation plus élevé et de la difficulté plus grande de congédier des travailleurs au Canada. Certains ont cependant mentionné que le souci du gouvernement canadien pour les fermetures d'entreprises leur avait épargné des coûts lors de fermetures d'usines. Il est intéressant de noter que le consensus des répondants était à l'effet que les États-Unis devraient exempter le Canada de l'application de ses politiques de protection contingente. Il note cependant la position officielle de Clayton Yeutter, le "United States Trade Representative", selon lequel cette exemption serait une demande irrecevable. Les répondants dans le secteur de l'acier et du bois d'oeuvre étaient cependant d'avis qu'il ne devrait pas y avoir d'exemption pour les Canadiens. Certains ont mentionné que l'établissement d'une zone de libre-échange nécessiterait des règles d'origine très serrées concernant un minimum de valeur ajoutée et de performance canadienne si on voulait éviter une pénétration inacceptable du marché américain via le Canada. Un répondant y voyait un besoin d'harmoniser sérieusement les tarifs principaux d'où, dans les faits, une union douanière.

On a noté l'amélioration du climat des investissements et nombre des répondants ont indiqué que le traitement national des entreprises à propriété américaine ne devrait pas être une condition essentielle dans la négociation par les Américains. La majorité des répondants, cependant, étaient d'avis qu'il faudrait qu'il y ait un accueil plus ouvert à l'investissement américain au Canada, quitte à restreindre l'investissement direct étranger dans quelques secteurs nationaux pour fins de sécurité nationale. La majorité voulait voir disparaître le tamisage des investissements directs étrangers concernant soit l'investissement nouveau ou l'acquisition. On voulait aussi voir disparaître les exigences concernant le contenu local, l'emploi, la R&D et les exportations. On donna donc beaucoup d'importance au principe de traitement national et le "National Foreign Trade

Council" a même suggéré qu'il y ait une entente spécifique portant sur l'investissement direct étranger entre les deux pays dans le cadre de l'entente globale.

En résumé, Erdilek est d'avis que les arguments des optimistes sont plus convaincants que ceux des pessimistes, quoique dans les deux cas il s'agit de spéculations et de suggestions plutôt que de conclusions fermes. Son enquête informelle auprès de 28 maisons mères de firmes transnationales américaines supporte l'argumentation des optimistes. Selon ces résultats à court terme, la zone de libre-échange augmenterait les exportations des maisons mères vers le Canada surtout de produits chimiques, plus que l'exportation des succursales vers les États-Unis. Dans la mesure où il y aurait une période de transition, les conséquences pour les succursales ne seraient pas significatives. Et ultérieurement la rationalisation et l'intégration de ces succursales avec leur maison mère diminuerait l'effet positif ayant favorisé les exportations américaines initialement. Selon les interlocuteurs, la rationalisation continentale des firmes transnationales américaines augmenterait leur compétitivité internationale. On a aussi signalé que la rationalisation de beaucoup des succursales canadiennes est plus probable dans le cadre d'une zone de libre-échange que sans une zone de libre-échange. Il s'agit d'un processus qui est déjà commencé. La réaction la plus probable serait de rationaliser et non pas de fermer la succursale canadienne. Il s'agirait donc de plus de spécialisation, de courses de production plus longue, de nouveaux produits, et pour certains produits de courses de production plus courtes dans les niches particulières pour le continent nord-américain et l'ensemble du monde. Dans certains cas, on se servirait beaucoup de nouvelles technologies, ce qui donnerait lieu à des réductions d'emploi. On devrait diminuer les interventions gouvernementales diverses et assurer que les tiers pays ne puissent pénétrer les États-Unis via le Canada. Une diminution de la réglementation canadienne, une amélioration des relations patronales ouvrières seraient aussi nécessaires selon les répondants. La majorité des répondants étaient d'accord avec l'établissement d'une zone de libre-échange mais croyaient que les chances de l'obtenir n'étaient que de 50%. On sent une opposition grandissante et un gouvernement vacillant au Canada, un manque d'intérêt public aux États-Unis et des groupes anti-zone de libre-échange très puissants dans chacun des deux pays.

Résumé détaillé

III. Elliot J. Feldman et Lily Gardner Feldman—Le nouveau fédéralisme américain et le commerce international

Dans leur bref historique du fédéralisme américain et de ses relations au commerce international, Elliot Feldman et Lily Gardner Feldman, de Tufts University, signalent que la présence américaine dans le commerce est définie par les corporations américaines et les firmes américaines transnationales, le rôle traditionnel des gouvernements étant de faciliter leurs activités et de favoriser leurs intérêts par des règles qui assurent une concurrence plus égale, ou du protectionnisme. Ils signalent que, d'autre part, les gouvernements des pays de l'Europe de l'Ouest, du Canada et du Japon ont mis sur pied des bureaucraties très impliquées dans les processus visant à améliorer les balances commerciales de leurs pays respectifs. Les déficits de la balance commerciale américaine ont donné lieu à la création du "Office of the Special Trade Representative" et à une responsabilité grandissante au gouvernement fédéral dans l'effort national pour protéger des emplois en augmentant les exportations et en diminuant les importations. Le ministère de l'Agriculture a initié divers programmes pour favoriser les ventes de produits agricoles à l'extérieur. Au milieu des années 1970, on parlait de stratégie industrielle nationale mais, exception faite de la notion de réciprocité à être négociée par le "Special Trade Representative" et la croyance concernant l'existence d'un lien entre le choix d'entreprises et de secteurs gagnants et leur succès dans le commerce international, il y avait peu de stratégies.

Au niveau des États, cependant, les gouverneurs étaient tenus responsables du chômage et plusieurs régions subissaient une dé-industrialisation importante. Ces développements expliquent en partie leur rôle grandissant dans le commerce international américain.

Le nouveau fédéralisme américain donna des responsabilités accrues aux États dans le développement économique. Ceux-ci décidèrent donc de s'impliquer directement dans l'économie internationale, malgré un régime constitutionnel qui donnait de telles responsabilités au Président et au Congrès. Au début des années 80, la participation des États est devenue plus prononcée et l'approche des Américains au commerce international fut modifiée. Malgré des coupures financières, l'implication des États pour favoriser les exportations de produits de leurs États augmentèrent.

Les Feldman passent en revue des réalités institutionnelles très différentes mises en place par les États dans leurs efforts de promotion des activités internationales. Les données existantes font qu'il existe de grandes difficultés pour en arriver à des estimés budgétaires assez précis concernant les implications des États dans de telles activités. Il semblerait que ceux-ci varient entre des budgets de 100 000 $ à 7 millions $. Au total, il semblerait que les États dépensent environ 50 millions de dollars annuellement pour fins de commerce international. Il se sont dotés d'environ 70 bureaux à l'étranger, bureaux dans lesquels on retrouve en règle générale deux professionnels et deux personnes de soutien. Le coût de ces bureaux varie entre 100 000 $ et 500 000 $, montant qu'on retrouve pour le bureau de la Californie à Tokyo et à Londres.

De plus, les autorités portuaires et les villes ont aussi des bureaux à l'étranger.

Essentiellement, les États sont impliqués dans la vente des produits issus de leur État et dans des essais d'attirer des investisseurs étrangers. Une certaine activité du côté du jumelage a eu lieu avec la Chine.

Plusieurs des programmes et activités des États recoupent celles du gouvernement fédéral. Dans certains cas, à savoir pour l'État de Washington et de l'Oklahoma, il y a des programmes conjoints avec le "United States Foreign Commercial Service". Ces programmes visent surtout à aider ceux qui exportent pour la première fois, en les aidant à trouver des marchés et à fonctionner dans les marchés internationaux. Le "Export Assistance Office" de l'État de Washington recherche des fonds fédéraux afin d'aider les PME de l'État de Washington à commencer leur activité dans le domaine international.

Les Feldman signalent l'existence d'un traitement fiscal visant les investissements dont l'impact est évident sur l'activité de l'exportation.

Durant les années 1950 et 1960, les activités des États étaient concentrées en Europe de l'Ouest. Dans les années 1980, on vise d'aller plus particulièrement à Tokyo, Singapour, Seoul et Hong Kong. Peu d'efforts sont faits vers le Canada. Il n'y aurait que 4 buraux d'États au Canada, 2 étant la propriété de l'État de New York, un étant la propriété du Vermont et l'autre de la Georgie.

Selon les Feldman, les États comme les provinces négligent les relations transfrontalières à ce niveau. Selon eux, le gouvernment canadien ne reconnaîtrait pas adéquatement les relations provinces/États comme dimension vitale des relations Canada/États-Unis.

Les Feldman signalent que les États du nord-est s'en remettent surtout à la "Conference of New England Governors and Eastern Canadian Premiers" pour traiter des relations transfrontalières avec le Canada.

Il y a peu de collaboration entre les États et, exception faite du "National Governors Association", il y a peu de possibilités systématiques pour fins d'interaction. Selon les Feldman, l'activité internationale des États a augmenté de façon si considérable que le gouvernment fédéral américain a tout simplement abandonné tout effort de mettre en application de façon rigide les articles constitutionnels américains.

Cette augmentation de l'activité internationale des États multiplie les divers moyens et mécanismes de politique étrangère américaine, multiplie le nombre de voies américaines à l'étranger, change le rôle traditionnel des gouverneurs et diversifie les relations internationales américaines. Selon les Feldman, on découvre tard l'importance du Sénat et du Congrès et on néglige à tort le "speaker of the house of representative" et les gouverneurs américains. Les gouverneurs étant intéressés et impliqués, les Feldman suggèrent qu'ils constituent un nouveau canal de communication sur le commerce international et un nouveau mécanisme pour fins de négociation. Les Feldman signalent que le gouvernement fédéral permet et même encourage des initiatives des États et des villes, sur le plan international, et qu'il en découle que des pays étrangers, dont le Canada, doivent tenir compte de ces activités afin de découvrir de nouveaux moyens de traiter avec les États-Unis.

Résumé détaillé

IV. Charles F. Doran—Trois hypothèses à vérifier concernant les questions culturelles et le commerce

Le professeur Charles F. Doran, directeur du "Center of Canadian Studies" à Johns Hopkins University à Washington discute de questions de culture et de commerce.

Sa première hypothèse est à l'effet que la culture canadienne est plus fragile que celle de beaucoup d'autres pays, dont certainement celle des États-Unis. Selon lui, culture signifie ce qu'on appelle "high culture" mais aussi ce qui est appelé "entertainment". Cette fragilité canadienne serait dûe aux origines linguistiques bilingues du pays. D'autre part, la dispersion régionale de la population rend difficile l'interaction. Selon Doran, les Canadiens ne se sentent ni Français ni Anglais et ils ne veulent pas non plus être Américains. Leur existence, tout près des États-Unis où la culture américaine les influence, ajoute à la complexité et à la fragilité de la culture canadienne. Doran signale que, pour les anglophones canadiens, 98% des deux heures par jour qu'ils passent en moyenne à la télévision, ils les passent à regarder la télévision américaine. Il note que trois des quatre livres que les Canadiens lisent sont publiés à l'extérieur, surtout aux États-Unis. Les trois quarts du revenu gagné dans la distribution des films au sein du Canada est gagné par des compagnies étrangères, surtout américaines. Selon Doran, on sait ce que les Canadiens ne veulent pas (à savoir les valeurs des Américains), mais on découvre difficilement ce qu'ils désirent. Selon Doran, cette fragilité de la culture canadienne affecte la conduite de sa politique des relations internationales.

La deuxième hypothèse de Doran est à l'effet que le commerce du Canada, même avec les États-Unis, a peu à faire avec la qualité de la culture canadienne. Selon Doran, la culture se transmet par des contacts personnels et des idées, plutôt que par des biens et services. Selon lui, l'impression au Canada de tous les livres, la production au Canada de tous les films et un contenu canadien à 100% à la télévision n'empêchera pas les flux

transfrontaliers très importants d'idées, de style de vie et des interactions personnelles. Les marchés noirs, les soucoupes de satellites et les cinémas à la frontière américaine se multiplieraient, selon lui. Selon Doran, les producteurs de biens et services veulent, sauf de rares exceptions, les rendre le plus neutre possible culturellement, afin de pouvoir les distribuer le plus largement au moindre coût. Partant d'un constat qu'il est impossible d'isoler le Canada d'un bombardement culturel extérieur et, d'autre part, que les biens et services sont développés de telle façon à être le plus neutre culturellement possible, Doran est d'avis qu'une entente bilatérale avec les Américains n'aurait pas d'impact très fondamental sur la culture canadienne. Selon lui, les subventions dans le domaine des arts, la qualité du système de soutien de sécurité du revenu, le système médical canadien et les subventions de recherche aux chercheurs ne sont pas négociables. Selon lui, les négociateurs américains ont insisté pour que ces items soient négociés, afin d'assurer que les intérêts particuliers américains ne réduisent pas la portée de l'entente avant même qu'elle ne soit négociée.

Il maintient d'autre part que l'approche canadienne a été d'exclure certains secteurs, dont la culture, afin de se concentrer sur leur objectif principal, à savoir un accès garanti au marché américain. Cette approche favorisait aussi l'acceptation de la part des provinces et de certains autres groupes. Selon Doran, l'objectif de soutien de la "high culture" est accepté dans les deux pays, quoique le financement soit plus public au Canada qu'aux États-Unis.

Il signale donc que l'entreprise américaine voulant concurrencer une entreprise canadienne pourra sembler désavantagée car les coûts de soutien et de sécurité du revenu et beaucoup de frais médicaux sont, au Canada, couverts par le secteur public alors qu'aux États-Unis, l'entreprise privée doit les assumer. Selon lui, les programmes sociaux canadiens ne sont pas visés car, si on tient compte de l'ensemble des coûts, ceux-ci ne seraient pas tellement différents entre le Canada et les États-Unis.

La définition de l'industrie culturelle englobe les périodiques, la publication de périodiques et livres, les disques, les films et les vidéos. D'autres ajoutent la radio et la télévision. Doran se demande où l'on peut tracer la ligne entre ce qui peut, d'une part, légitimement être considéré comme un renforcement de la culture canadienne et, d'autre part, ce qui est dans les faits une protection superficielle analogue à la protection donnée dans certaines industries aux dépens du consommateur. Il se demande jusqu'à quel point le piratage des programmes de télévision américains auxquels on enlève les annonces commerciales, la protection donnée aux manuels de sciences et d'ingénierie, le cas "Prentice-Hall" où l'intervention et le motif allégué étaient d'assurer la publication d'un pourcentage plus élevé d'auteurs canadiens, ne sont pas de bons exemples de la difficulté de distinguer entre objectifs culturels appropriés et protectionnisme économique tout simplement.

Selon Doran, un ratio plus élevé d'auteurs canadiens dans une maison d'édition canadienne que dans une maison de publication à propriété étrangère peut résulter de nombre de facteurs. D'abord, il se peut que les maisons à propriété canadienne recherchent plus activement les auteurs canadiens. D'autre part, il se peut que les maisons de publication à propriété étrangère ne veuillent que modifier sommairement leurs produits américains sans y ajouter le coût d'édition afin d'augmenter leur marché.

Une autre possibilité serait que les maisons canadiennes n'ayant pas de réseau de distribution nord-américain se concentrent nécessairement sur ce qu'elles connaissent le mieux, le marché canadien. Il se peut aussi que les firmes canadiennes discriminent consciemment contre les auteurs de l'extérieur en faveur des auteurs canadiens. La raison économique motivant un tel comportement est l'obtention de subventions qui ne sont pas disponibles aux maisons étrangères. Doran ne trouve pas cet argument très intéressant. Il conseille donc de porter beaucoup d'attention au processus de formulation de politiques dans le domaine culturel, afin de bien discerner les motifs qui sous-tendent les demandes de subventions.

Doran croit que son argument à l'effet que la libéralisation des échanges n'est pas un danger pour l'identité culturelle canadienne est renforcé parce que certaines politiques culturelles canadiennes ont justement des effets pervers sur le renforcement de l'identité culturelle canadienne. Selon lui, la restriction quant au rapatriement des profits et des royautés et les restrictions quant aux ventes de succursales étrangères a pour effet de garder au Canada, dans le domaine culturel, certains investissements étrangers. Sans ces restrictions, beaucoup de ces entreprises étrangères auraient déjà vendu leurs actifs, à une firme canadienne probablement.

Selon lui, le protectionnisme dans les industries culturelles génère des profits monopolistiques aux propriétaires de chaînes de télévision, de radio, de magazines et de quotidiens. Les prix des produits culturels canadiens étant en conséquence plus élevés, ceux-ci en achètent moins. D'autre part, la protection accordée dans le domaine du disque, de la publication et du vidéo traite ces entreprises comme des entreprises naissantes ("infant industries") ce qui les empêche de tenter de développer leur marché hors du Canada. Ce fait empêche les Canadiens de profiter des économies d'échelle qui découleraient d'initiatives globales. Il croit donc que la libéralisation des échanges pourrait faire augmenter la place du capital canadien dans ces industries. Il est cependant sceptique que la propriété canadienne et le contrôle canadien rendraient ces industries plus canadiennes.

La troisième hypothèse de Doran est à l'effet que de nombreux Canadiens exagèrent la fragilité de la culture canadienne et rejettent l'hypothèse à l'effet qu'une libéralisation des échanges avec les Américains n'aurait pas d'impact sur le domaine culturel, l'éducation, les communications et les loisirs au Canada. Selon lui, le gouvernement canadien continuera donc de réagir en légiférant pour protéger la culture canadienne. De plus, selon Doran, plus Ottawa tentera de protéger la culture canadienne, plus Québec tentera d'assurer la pureté et la vitalité de la culture québécoise. Selon Doran, il est tentant, politiquement, d'utiliser les États-Unis comme cible. Selon lui, si les États-Unis n'existaient pas, il faudrait les créer car au Canada l'image d'une menace extérieure a une force unificatrice. Il signale aussi que le Québec tente de tirer profit de ses liens avec les États-Unis afin de tirer des privilèges d'Ottawa.

Doran passe en revue les mesures canadiennes et américaines qui tentent de sauvegarder les industries culturelles. Il trouve que ce n'est que dans le cas de la propriété locale de chaînes de télévision et de radio que la protection est analogue. Dans tous les autres cas, les restrictions canadiennes dans le domaine culturel sont plus

considérables, comme d'ailleurs le sont la propriété étrangère et le contrôle étranger au Canada.

Doran passe aussi en revue un autre argument où on tente de faire une équation entre sécurité nationale et souveraineté culturelle, afin d'assurer que les négociations ne portent sur ni l'un ni l'autre. Il ne trouve pas ces arguments convaincants parce que le Canada n'est pas considéré comme une menace à la sécurité nationale américaine, alors que les Américains le sont sur la souverainneté culturelle canadienne. Selon lui, la sécurité nationale américaine est équivalente à la sécurité nationale canadienne, l'inverse étant aussi le cas. D'autre part, grâce à l'accord du pacte de la défense, l'industrie canadienne a pu profiter des politiques d'achat des Américains. Il signale l'existence de soucis particuliers concernant des renseignements sensibles qu'on retrouve dans le domaine de la défense et qui n'existaient pas dans le domaine non militaire. Il trouve que l'argumentation de la sécurité nationale peut-être poussée trop loin et donner lieu à des entraves au flux de commerce et facteurs de production. Selon lui, l'argumentation canadienne voulant que le domaine culturel soit exclu sera vraisemblablement acceptée car on apprécie aux États-Unis la sensibilité des Canadiens sur le sujet. Cependant, tout essai d'augmenter la protection culturelle serait vraisemblablement résisté. Il signale que les Américains ne seraient pas très heureux de voir le Canada s'inspirer de la Politique Nationale de l'Énergie pour canadianiser le secteur culturel.

Doran est aussi d'avis que si les entreprises des secteurs culturels se diversifient vers d'autres secteurs industriels, tout en demandant le protectionnisme dans leurs activités culturelles, elles trouveront les Américains très peu sympathiques à la protection actuelle.

Il est d'avis aussi que les Américains seraient très peu enclins à reconnaître le protectionnisme culturel canadien si les entreprises canadiennes impliquées augmentent considérablement leurs activités sur le marché américain.

Selon Doran, le fait que bon nombre de Canadiens croient que la culture canadienne est fragile et menacée est suffisant pour inciter le gouvernement canadien à adopter des programmes culturels et dépenser dans les 75 milliards de dollars pour augmenter et renforcer la culture canadienne. Il croit donc que le Canada réussira dans ses efforts de perpétuer des barrières non-tarifaires actuelles en faveur des industries culturelles.

En conclusion, il est d'avis qu'il existe au Canada un dilemme culturel que les Américains doivent reconnaître. Les Américains doivent donc reconnaître la question culturelle comme étant importante parce que les Canadiens la considèrent ainsi et agiront en conséquence.

Il maintient cependant qu'il y a de bonnes façons et de mauvaises façons de stimuler la culture et les loisirs canadiens. Selon lui, il faut discuter de la méthode employée même si on ne critique pas le principe.

Tout en reconnaissant le droit d'une société d'établir une réglementation dans le domaine culturel, il maintient qu'une société ne devrait pas prétendre que seulement un Canadien ou un Américain peut écrire un livre adéquatement. Une société ne devrait

pas, selon lui, prétendre que soit seulement une entreprise canadienne ou américaine peut vendre les produits culturels partant du critère d'identité nationale de l'entreprise qui les vend ou de la citoyenneté de l'artiste ou de l'auteur qui les a créés. Il voit donc une grande différence entre défendre le principe de la souveraineté culturelle et défendre les moyens pour la promouvoir. Selon lui, il est indiqué que les États-Unis acceptent le principe de la souveraineté culturelle canadienne et il est indiqué pour les Canadiens de reconnaître que certaines méthodes de protection de cette souveraineté sont sujettes à question. Il signale aussi que si le Canada réussit dans sa demande d'exclusion ou de protection du secteur culturel, il faudra aussi qu'il considère les coûts pour obtenir cette protection.

On comprendra que de tels propos aient donné lieu à une discussion animée de la part de Jacques Godbout, auteur et cinéaste de l'Office national du film, et des participants au colloque. Entre autres propos, le protectionnisme de la France et de la Belgique vis-à-vis des produits culturels québécois et le potentiel de croissance moindre de vente des produits francophones sur le marché américain ont été évoqués pour suggérer d'autres éléments dans la discussion.

Résumé détaillé

V. Gary C. Hufbauer—Une introduction aux mécanismes législatifs et administratifs de la politique commerciale aux États-Unis

Dans sa communication, Gary C. Hufbauer, "Wallenburg Professor of International Financial Diplomacy" à Georgetown University, nous fait part d'un examen d'aspects choisis des processus législatifs et administratifs de la politique commerciale américaine.

Hufbauer identifie le grand nombre d'acteurs impliqués dans la politique commerciale américaine, à partir du Président et du Congrès, en passant par la "International Trade Commission", le "United States Trade Representative", la "International Trade Administration" du "Department of Commerce", ainsi que plusieurs acteurs du secteur privé tels des compagnies et associations industrielles.

Selon les pères fondateurs des États-Unis, le Congrès a la responsabilité de réglementer le commerce étranger et le Président la tâche de conduire la politique des relations internationales. Au jour le jour, ces activités n'impliquent ni le Président ni le Congrès. Cependant, lorsqu'on en vient à de nouvelles initiatives, le rôle du Congrès devient prépondérant. C'est lui qui peut proposer de nouvelles législations et définir la portée des ententes commerciales. Certains membres du Congrès sont très attentifs à leurs électeurs dans le domaine de la politique commerciale.

Le Président peut lui aussi initier de nouvelles législations et tenter d'influencer le Congrès et résorber des conflits commerciaux entre les États-Unis et d'autres pays, ainsi que faire l'arbitrage des différends entre les diverses agences de l'exécutif.

Le "United States Trade Representative", bureau désigné pour la mise au point et la négociation de la politique par le Président, doit cependant être très sensible aux propos du Congrès. Lorsqu'il y a des demandes d'imposition de droits compensatoires, par

exemple, la "International Trade Administration" du "Department of Commerce" (ITA) détermine si celles-ci sont justifiées et si oui leur niveau, alors que la "International Trade Commission" (ITC) détermine s'il y a eu préjudice dans l'industrie qui demande la protection. Le ministère du Travail documente les effets des importations sur l'emploi, le ministère de l'Agriculture formule largement la politique agricole, la "Export-Import Bank" fait la promotion des exportations par le financement, le ministère de la Défense compta bilise et suit les exportations de produits de haute technologie.

Les "Treasury Department" et "State Department" assurent que la politique commerciale soit conciliable avec la politique économique et avec la politique des relations internationales. Il y a aussi une grande diversité d'autres acteurs et les "Business Roundtable", "United States Chamber of Commerce", "National Association of Manufacturers", "U.S. Council for International Business" et la "AFL-CIO" examinent presque toutes les initiatives majeures concernant la compétitivité internationale des États-Unis.

Hufbauer identifie les divergences d'opinions qu'on observe au sein du secteur privé et au sein du secteur public américain. Soucieux des implications pour la politique des relations internationales des États-Unis, les Présidents ont en règle générale résisté aux mesures protectionnistes ou accepté des solutions ad hoc afin d'être accomodants pour les intérêts des producteurs étrangers.

Hufbauer décrit ensuite les options et démarches possibles au secteur privé voulant restreindre les importations dans le cadre des législations américaines actuelles.

Il existe quatre catégories d'actions possibles: 1) "Escape clause relief", (mesures de sauvegarde) lorsque les importations, quoique loyales, créent un préjudice interne; 2) les mesures statutaires pour traiter de commerce déloyal, tels le dumping et les subventions, dont les droits compensatoires; 3) les mesures discrétionnaires du Président pour restreindre quantitativement des importations; et 4) des quotas émis par le Congrès.

Dans sa discussion de "Escape clause relief", Hufbauer note que, selon l'article XIX du GATT, cette mesure devrait être temporaire alors qu'en pratique elle a persisté dans les textiles, l'agriculture et le fer pour traiter de problèmes des entreprises de taille moyenne ou petite. Il s'agit d'une démarche transparente et il est entendu que l'État, en demandant une exemption du genre, doit faire des concessions tarifaires sur d'autres produits en échange. Cette protection doit être non discriminatoire entre les membres du GATT, ce qui suggère l'établissement d'un tarif multilatéral plutôt qu'un quota bilatéral. Les demandes de "Escape clause relief" sont présentées à la "International Trade Commission", laquelle détermine s'il y a eu un préjudice sérieux ou un préjudice anticipé sérieux à cause des importations impliquées. Si les membres de la ITC recommandent la protection, le Président détermine s'il y a lieu d'y accéder et comment elle doit être effectuée. Hufbauer note qu'entre 1975 et 1984, le Président n'a accepté que 13 des 53 cas soumis à la "International Trade Commission".

Hufbauer signale que, présentement, les procédures concernant le commerce déloyal anti-dumping et les droits compensatoires sont très précis et serrés. On peut imposer des droits anti-dumping lorsque les importations sont vendues à un prix moins

que "fair-value" et que ces ventes créent un préjudice à l'industrie domestique. La norme utilisée est le prix domestique du produit sur le marché de l'exportateur et, dans certains cas, on doit estimer une telle valeur. La ITA détermine s'il y a eu du dumping, alors que la ITC détermine s'il y eu un préjudice et ce dans les 45 jours qui suivent la demande initiée par le secteur privé. La ITA publie sa décision initiale dans les 160 jours qui suivent la demande initiale. Si la ITA détermine qu'il y a eu dumping, la ITC fait une décision finale quant à l'ampleur du préjudice. Et si cette décision est positive, ou impose un droit anti-dumping.

Il existe aux États-Unis deux genres de droits compensatoires; un visant les pays signataires du GATT, l'autre pour ceux qui n'en sont pas membres. Si les membres sont signataires du GATT, les procédures nécessitent qu'on démontre l'existence d'une subvention et d'un préjudice domestique. Si le pays n'est pas membre, le besoin de démontrer le préjudice ne s'applique pas.

La ITC fait une étude préliminaire de la question et, dans les 85 jours, la ITA doit faire une décision concernant l'existence d'une subvention. Si la décision est positive, les importations ultérieures sont sujettes à un droit compensatoire. Suit une étude très détaillée par la ITA où des questionnaires sont envoyés aux gouvernements étrangers et aux compagnies étrangères. Dans les 75 jours de la publication de la décision initiale, la ITA rend sa décision finale. Si celle-ci est affirmative, la ITC fait sa décision finale sur la question de préjudice. À la fin de sa démarche, chacune des parties peut faire appel à la "Court of International Trade". Il est aussi prévu un examen judiciaire de ces cas.

Quoique le Président soit exclu des procédures que nous venons de mentionner, il y a encore beaucoup de discussion quant à la nature de la protection qui sera accordée. Lorsque des restrictions quantitatives sont désirées, le USTR doit négocier une entente avec les pays exportateurs. Ceux-ci sont connus comme étant des restrictions volontaires des exportations, ou des "Orderly Marketing Arrangements", lesquels sont régis principalement par les pays exportateurs eux-mêmes. Des exemples sont l'Accord Multifibres, la restriction volontaire sur les importations de l'acier du Président Reagan et les restrictions récentes sur les importations de semi-conducteurs japonais. Les restrictions quantitatives sont devenues la méthode préférée de la "Executive Branch", surtout lorsqu'il s'agit de grandes industries ayant des difficultés.

Lorsqu'une industrie influente n'a pas réussi à obtenir de la protection par les moyens actuels, elle peut tenter d'inciter le Congrès à passer des législations pour limiter effectivement les importations. Ces législations, contrairement aux restrictions volontaires aux importations, ne sont ni flexibles, ni temporaires. À titre d'exemple, on peut citer le "Jones Act" de 1920, le "Meat Act" de 1964 et le "Magnuson Fisheries Act" de 1976. Le "Jenkins Amendment", qui aurait restreint les importations de textiles et de vêtements, fut accepté par le Congrès. Le Président y mit cependant son veto. On sait que le Congrès tente maintenant de limiter la discrétion au Président dans ces questions.

Hufbauer discute ensuite en détail d'un cas très pertinent lors de la tenue du colloque, à savoir celui du bois mou. Nombreux Canadiens profiteront de lire en détail cette perception d'un Américain averti dans un domaine qui a fait couler beaucoup d'encre au Canada. Hufbauer nous parle de l'initiative du 7 octobre 1981 du "Coalition for

Fair Canadian Lumber Imports" à l'égard d'une subvention "inacceptable" du fait que les droits de coupe canadiens étaient vendus à des prix qui équivalaient, selon eux, à une subvention de 27 à 40%. Le Canada étant membre du GATT, l'industrie du bois d'oeuvre américaine devait démontrer qu'il y avait préjudice et subvention. Hufbauer nous rappelle que le ITC a décidé en novembre 1982 qu'il y avait préjudice à l'industrie américaine.

C'est ainsi qu'en mars 1983, après un délai additionnel, la ITA avait émis une décision préliminaire à l'effet qu'il n'y avait pas de subventions. La ITA confirma d'ailleurs cette décision en mai 1983.

Hufbauer note que la ITA a accepté l'argument à l'effet que les droits de coupe étaient disponibles largement et donc analogues à des chemins, des ports ou des écoles.

Hufbauer nous signale qu'un groupe différent ad hoc dans le domaine du bois d'oeuvre soumit une nouvelle pétition le 19 mai 1983. De plus, l'industrie américaine du bois d'oeuvre avait comme première option de tenter de faire changer la législation américaine concernant les droits de coupe canadiens et comme deuxième option de tenter de faire redéfinir le concept de subventions donnant lieu à un droit compensatoire. Ils suivirent les deux voies. Hufbauer nous signale qu'en mars et avril 1983, dans les procédures du "Trade subcommittee of the House Committee on Ways and Means", on s'intéressait particulièrement à l'exemption des subventions dans le domaine des ressources naturelles, lesquelles étaient exclues de la portée de droits compensatoires américains. On proposa en octobre une législation à l'effet qu'on étende les droits compensatoires américains pour couvrir des produits exportés aux États-Unis qui recevaient un bénéfice du fait qu'ils profitaient de la propriété publique des ressources naturelles. Si le prix domestique de la ressource était inférieur au prix d'exportation, ou moins que le prix mondial, ou moins que le prix disponible au producteur américain, un droit compensatoire pourrait être levé contre les produits incorporant cette ressource naturelle. Les raffineurs de pétrole, les producteurs de produits chimiques, les producteurs d'engrais et les compagnies dans le domaine du bois auraient profité d'une telle modalité. Cette proposition fut incluse dans H.R. 4784, *The Trade Remedies Reform Act*, passé ultérieurement par la "House of Representatives". Une législation parallèle passée par le Sénat n'inclut pas cependant cette mesure concernant les subventions dans le domaine des ressources naturelles. L'administration Reagan y était d'ailleurs opposée. La mesure fut discutée lors d'un comité conjoint de la "House of Representatives" et du Sénat, qui produisit le "Trade and Tariff Act" de 1984.

Les industries affectées continuèrent leur lobbying et on eut le "Gibbon's Amendment" qui mentionnait très explicitement le droit de coupe pour le bois d'oeuvre. Hufbauer note que certains intérêts américains, à savoir des distributeurs de pétrole, les constructeurs d'habitation, les fermiers, et les détaillants dans le domaine du bois, s'opposèrent à cette législation. Malgré cette opposition, Hufbauer note que l'amendement de Gibbons fut passé par la "House of Representatives" et inclus dans le "Trade Reform Bill". Hufbauer prétend que cette question de subventions sur les ressources naturelles devra attendre le "Trade Act" de 1987. Il nous signale aussi un fait peu connu des Canadiens à l'effet que lors de la discussion du Président Reagan et du Congrès concernant l'utilisation possible de la procédure accélérée (fast track) en fin 1985

début 1986, le sénateur Packwood, président du "Finance Committee", avisa en février 1986 l'Administration que l'autorité "fast track" pour les discussions bilatérales dépendait d'une solution au problème du bois d'oeuvre.

En avril 1986, le USTR indiqua aux négociateurs canadiens que si la question du bois d'oeuvre n'était pas réglée, les Américains la régleraient unilatéralement. Le Premier Ministre Mulroney indiqua que le Canada se retirerait des discussions bilatérales à moins que l'autorisation soit donnée pour utiliser la voie accélérée. Au dernier moment, le "Senate Finance Committee" donna à l'Administration Reagan l'autorisation d'utiliser la voie accélérée, mais pas sans lui exiger certaines concessions. Reagan indiqua au sénateur Packwood que les États-Unis invoqueraient une loi contre les subventions canadiennes dans le domaine du bois d'oeuvre si les négociations bilatérales ne donnaient pas une solution à ce problème. Le président Reagan et l'industrie du bois d'oeuvre américain demanda à la "Coalition for Fair Lumber Imports" de retarder la soumission d'une nouvelle demande de droits compensatoires. Plutôt que de proposer une solution définitive à ce problème, les Canadiens suggérèrent une autre ronde de négociations, ce qui ne fut apprécié ni par le Président, ni par l'industrie américaine. En conséquence, le 19 mai 1986, la demande de droits compensatoires fut resoumise, cette fois-ci avec le support de l'Administration. La ITA indiqua d'ailleurs qu'elle repenserait à sa définition d'une subvention dans le domaine des ressources naturelles à la lumière du cas "carbon black" du Mexique, où son argumentation concernant la disponibilité générale d'une subvention avait été renversée par la "Court of International Trade". D'autre part, et ce n'est pas une coïncidence nous signale Hufbauer, le président Reagan instaura un tarif de 35% sur les plaquettes, de bois (shakes and shingles). On sait que le Canada imposa des tarifs sur certains produits, retarda sa décision dans le domaine pharmaceutique et demanda une enquête formelle au GATT. Les négociateurs canadiens se retirèrent aussi des discussions bilatérales visant à négocier la question du bois d'oeuvre. Les Américains interprétèrent l'annonce faite par Mme la Ministre Pat Carney, le 9 septembre 1986, lors d'une rencontre avec le "Secretary of Commerce" Malcolm Baldridge, à l'effet que la Colombie-Britannique allait examiner les droits de coupe comme étant une indication que les Canadiens étaient prêts à négocier. On espérait donc qu'une entente intergouvernementale pourrait être arrêtée sur le sujet. L'industrie du bois d'oeuvre américain publia cependant, le 9 septembre, un nouveau mémoire dans lequel elle alléguait l'existence d'une subvention de 32% et précisait géographiquement et industriellement la portée de cette subvention. On avait exclu les produits du papier de l'est du Canada et on se concentrait sur le bois d'oeuvre de l'ouest et une nouvelle pratique de droit compensatoire connue comme "sawtooth stumpage".

Le 30 septembre, le gouvernement canadien offrit d'imposer une douane équivalente à 10% sur le bois mou soit par l'utilisation de droits de coupe plus élevés dans certaines provinces ou une surcharge aux exportations dans d'autres. Cette proposition demandait à l'industrie américaine de laisser tomber sa demande de droits compensatoires et de laisser tomber son lobbying en faveur d'une nouvelle législation dans le domaine des ressources naturelles au Congrès. Cette proposition d'environ 350 millions de dollars était de beaucoup inférieure aux 32% demandés par l'industrie du bois américaine.

Selon Hufbauer, le cas du bois d'oeuvre illustre la nature de la politique et de la législation américaine, laquelle est caractérisée par la complexité et la confusion. L'industrie américaine peut utiliser divers canaux pour manifester son mécontentement soit auprès du Congrès, du USTR, du "Department of Commerce", du "Senate Finance Committee" et de la Maison Blanche. Alors que l'industrie américaine y voit des opportunités, le gouvernement canadien y voit le chaos. Les énergies canadiennes sont dissipées entre le "Senate Finance Committee", le "Commerce Department", la Maison Blanche et l'industrie américaine elle-même.

Selon Hufbauer les Canadiens préféreraient avoir affaire à un système américain plus centralisé dans ces questions. Ils voudraient, selon lui, que l'autorité dans le domaine commercial des États-Unis soit concentrée auprès du "United States Trade Representative" lequel se rapporterait à la Maison Blanche. Ceci permettrait des discussions de gouvernement à gouvernement et favoriserait des contacts personnels entre les négociateurs.

De nombreux intérêts américains ne sont pas de cet avis. Ceux-ci craignent la centralisation de la politique commerciale américaine et sont soucieux des possibilités qu'on donne des pouvoirs discrétionnaires à la branche exécutive du gouvernement américain. Hufbauer termine en disant qu'il se peut que les négociations bilatérales en cours donnent lieu à une commission Canada/États-Unis, dont l'objet serait de faire du monitoring et de tenter de diminuer l'ampleur de ces divergences. On pourrait permettre à cette commission d'être un des participants avec un statut reconnu devant la ITA, la ITC et les mécanismes analogues au Canada. Selon Hufbauer, il est cependant peu probable que les pouvoirs dans le domaine commercial, maintenant dispersés ici et là dans le gouvernement américain, soient centralisés ou que les procédures judiciaires américaines soient remplacées par une approche discrétionnaire.

Résumé détaillé

VI. Ann Markusen — Le rôle de la politique de la défense dans le développement industriel, commercial et régional aux États-Unis

Dans sa communication, Ann Markusen fait ressortir les effets industriels et régionaux de la politique de la défense américaine, lesquels seraient ressentis plus fortement au Canada suite à une libéralisation des échanges. Elle tente de démontrer que la libéralisation n'aurait pas un impact aussi positif qu'on le voudrait sur les secteurs canadiens orientés vers le matériel de la défense. Selon Markusen, le budget militaire a servi de facto de politique industrielle aux États-Unis et est en partie responsable des inefficacités et des distortions introduites par l'investissement et l'innovation axés sur les besoins militaires. Selon elle, les dépenses militaires ont été analogues à une politique industrielle aux États-Unis dans le sens qu'elles ont les caractéristiques suivantes: elles sont axées sur des secteurs spécifiques de l'économie ayant un potentiel de croissance à long terme et de croissance dans l'emploi et la production; on y offre des subventions de R & D aux entreprises impliquées; on favorise l'innovation technologique et on subventionne les investissements majeurs de façon privilégiée; le gouvernement utilise sa politique d'achat pour stabiliser le secteur; on offre, dans certains cas, une promotion aux exportations et/ou de la protection. De plus, les politiques industrielles et, jusqu'à un certain point, la politique militaire, comprennent une politique d'adaptation industrielle pour les travailleurs déplacés et les communautés ainsi que la formation du personnel et une reconversion des installations rendues vétustes.

La politique de la défense américaine a canalisé des ressources financières vers un petit nombre d'entreprises de haute technologie très dépendantes de contrats militaires, tels l'avionnerie et les missiles, l'équipement de communication et l'électronique. Elle a protégé le marché pour ces produits par la politique "Buy America", encouragé l'utilisation de CAO/FAO et de production flexible, construit et loué des infra-structures

aux contracteurs de la défense et aidé certaines communautés à se redévelopper et former les travailleurs suite à la fermeture des établissements impliqués. Jusqu'à la Deuxième Guerre Mondiale, le gouvernement fédéral était responsable d'environ 15% du financement de la R & D aux États-Unis. En ce qui concerne la R & D des années 1960, sa part était d'au-delà de 60% et elle n'a pas diminué depuis. La part militaire a aussi augmenté aux dépens de la part civile. En 1980, au-delà de 50% des dépenses du gouvernement fédéral pour la recherche, dépenses au niveau de 30 milliards de dollars, étaient pour des fins militaires. En 1985, on estime que la part militaire est de 70% d'un total de 50 milliards de dollars. La part du Pentagone dans le budget fédéral a augmenté de 23% en 1980 à 27% en 1985. Au sein du budget militaire, les dépenses se sont orientées de plus en plus vers l'investissement en capital militaire et les équipements militaires. Il s'agit donc de "hardware" pour les forces conventionnelles, à savoir des avions, des sous marins, des hélicoptères, des missiles, etc. Il s'est aussi produit une augmentation parallèle dans la croissance des exportations d'armes, la part américaine étant maintenant de 45% du total mondial, comparativement à 20% en 1970.

L'impact de ces dépenses militaires sur certaines industries de haute technologie n'est pas accidentel car il est reconnu comme étant un objectif qu'on mentionne avec la sécurité nationale. Dans le budget pour la guerre des étoiles, 600 millions de dollars sont donnés pour 5 ans afin de favoriser le développement industriel via de nouveaux ordinateurs, de nouvelles applications des ordinateurs et de nouvelles techniques de développement et de méthodologie de logiciels. Selon Markusen, la dépense militaire est une des façons d'avoir un impact domestique partant des politiques qui servent un rôle d'expansion macro-économique contrairement aux dépenses des consommateurs, lesquelles sont allées vers les importations, car on peut orienter les achats militaires vers les entreprises domestiques. Le ministère de la Défense pratiquerait une "Buy America Policy" alors que les ministères du Commerce et du Trésor favoriseraient le libre-échange.

C'est au sein du secteur secondaire américain qu'on retrouve les secteurs dont plus de 10% de la production dépend directement ou indirectement du ministère de la Défense, sauf pour ce qui a trait à la construction militaire. Les transports et le secteur minier sont les autres secteurs qui bénéficient indirectement de la politique de la défense. Tout cela signifie que les industries stimulées par l'augmentation de la dépense militaire diffèrent de celles qui ont été importantes dans le passé. Auparavant, les dépenses militaires favorisaient l'acier, la machinerie lourde et la construction, alors que maintenant il s'agit d'industries de haute technologie. En 1987, la part militaire de la production du secteur des communications américain était de 63%. Les industries des semi- conducteurs et des ordinateurs bénéficient aussi directement de cette augmentation dans les dépenses militaires. Il n'y a seulement que 6,7% de l'acier et 7,5% des machines-outils qui sont destinés à la demande militaire en 1987. Ces résultats résultent du fait que le gros des dépenses pour les fins d'armements modernes vont vers les techniciens et les ingénieurs qui font le design, l'assemblage et le test de ces systèmes cybernétiques pour faire fonctionner les missiles, les bateaux, les sous-marins, les avions de guerre, etc. La valeur de l'aluminium ou de l'acier dans ces produits est minuscule. L'augmentation dans ces secteurs a aussi donné lieu à une demande accrue vers l'ingénierie aéronautique et électrique aux dépens de l'ingénierie industrielle. De ce fait, les secteur. manufacturiers

américains ont été, selon Markusen, dans une position relativement faible pour profiter de l'innovation émanant de ce complexe industriel de la défense.

Selon Markusen, les complexes manufacturiers dirigés par les besoins de la défense ont eu des impacts très particuliers sur le développement régional aux États-Unis. La croissance dans l'emploi attribuable aux dépenses de la défense a eu lieu dans le périmètre de la défense partant de la région de Boston, allant vers le sud à travers le Connecticut, Long Island jusqu'à New Port Mews, Huntsville, Alabama, et Melbourne, Floride, traversant jusqu'à Dallas et Houston et englobant beaucoup de l'ouest entre les montagnes et le bassin du Pacifique. Ce sont des centres métropolitains tels Anaheim, Worcester, Dallas, Houston et Lakeland en Floride, qui ont le plus gagné d'emploi. Régionalement, c'est la région du Pacifique qui a les dépenses militaires les plus élevées per capita. Les autres régions, où la moyenne per capita est plus élevée que la moyenne nationale, sont les "Mountain States", la Nouvelle-Angleterre et la région Sud-Atlantique, dans l'ordre. La Nouvelle-Angleterre et la région du Pacifique ont beaucoup profité des achats militaires, alors que la région des montagnes et du Sud de l'Atlantique ont reçu une part plus que proportionnelle des bases militaires, du personnel et des salaires. Markusen signale qu'aucune des régions intérieures des États-Unis ne se sont approchées de la moyenne nationale des dépenses militaires. Les expéditions militaires originent surtout de Californie, de l'Arizona et du Utah, alors que l'Oregon et l'Idaho n'ont presque pas de secteurs secondaires reliés aux dépenses militaires. De même, l'Atlantique du sud, la Floride, le Maryland et la Virginie sont de grands gagnants, alors que les Carolines et la Virginie de l'ouest figurent au bas de l'échelle. Exception faite du Missouri et du Kansas, aucun autre état n'étant pas sur des côtes entre les Appalaches et les Montagnes Rocheuses ne figure parmi les 15 premiers secteurs. On trouve parmi les 15 derniers états le Wisconsin et le Michigan.

Il se dégagerait de ceci une reconstruction de la capacité industrielle dans des régions toutes nouvelles et influencées par les priorités de la politique de la défense. Alors que les manufacturiers conventionnels se localisent afin de minimiser leurs coûts entre les sites majeurs de ressources et les marchés majeurs de consommation, étant donné un calcul des coûts de transport, les producteurs dans le domaine militaire sont très "mobiles" par rapport aux ressources et au marché. Selon Markusen, l'endroit où est situé le client est de peu d'importance parce que le produit est mobile et sa destination souvent changeable et secrète. Les nouveaux endroits où on retrouve ces manufacturiers ne disposaient pas préalablement de ressources considérables de main d'oeuvre professionnelle et technique. Celles-ci furent créées lors de l'arrivée de l'établissement militaire. Cette constitution des ressources considérables de main d'oeuvre a été rendue possible par la pratique du ministère de la Défense de payer les coûts de mobilité du personnel recruté ailleurs.

On a vu comme résultat une désindustrialisation accrue du coeur industriel des États-Unis, partant des Appalaches jusqu'aux Rocheuses.

Selon Markusen, la divergeance dans la croissance régionale de l'emploi fut affectée principalement par les différentiels dans la perte d'emplois manufacturiers. Elle signale que 3 états, la Californie, le Texas et la Floride, virent la création de 920 000 emplois manufacturiers entre 1972 et 1984, alors que les 5 états industriels qui forment le

coeur du "Industrial heartland" perdirent 737 000 emplois. Presque tous les états à l'est du Mississippi perdirent des emplois manufacturiers, exception faite du New Hampshire, de la Floride et de la Géorgie. Dans l'ouest, certains états firent des gains significatifs d'emplois manufacturiers, en partie à cause d'un mouvement vers des "right-to-work states" (la question de syndicalisation est importante), et à cause de la création d'emploi dans le secteur manufacturier relié à la défense. Elle signale que toutes les régions intérieures des États-Unis ont subi une migration nette négative au début des années 80. Les états du coeur industriel perdirent même au niveau de la population globale. Le Michigan et l'Ohio, perdant 125 000 personnes, l'Indiana, l'Illinois, et le Wisconsin n'en gagnant que très très peu entre 1980 et 1985. C'est dans le "sunbelt" qu'on retrouve 90% de l'augmentation de 12 millions de la population américaine entre 1980 et 1985.

Selon Markusen, la libéralisation des échanges aurait pour effet de stabiliser ou de faire diminuer la part des importations américaines provenant du Canada. La part constituée de biens de production augmenterait cependant lentement.

Selon Markusen, beaucoup de complexes industriels canadiens ressemblent en partie à celui du mid-west et des Grands Lacs et dépendent de la viabilité des biens de production et de consommation durables.

Elle postule que, tout comme dans le mid-west, le Canada est concentré dans des secteurs qui ne profitent pas des secteurs privilégiés par la politique de la défense américaine, quoiqu'on retrouve chez les producteurs canadiens la production d'équipement de télé-communication et des pièces d'avionnerie. Sont absentes du complexe industriel canadien la production d'équipement électronique, d'ordinateurs et des équipements scientifiques, secteurs importants aux fournisseurs du Pentagone.

Selon Markusen, si les dépenses militaires américaines ont un effet positif sur les producteurs canadiens, ce sera via une demande indirecte pour des matériaux, des pièces et de la machinerie. Dans ces secteurs, cependant, le ministère de la Défense suit une politique d'achat "Buy America" qui favorise les firmes domestiques américaines. Selon elle, ce serait plutôt des petites entreprises canadiennes très compétitives qui profiteraient de commandes relativement moyennes. L'effet négatif venant du changement de la composition de la demande américaine mue par la politique de la défense pourrait avoir un deuxième effet, celui-là négatif, sur les pièces, matériaux et producteurs de machineries canadiens. Il se peut cependant que, puisque l'ingénierie et la R & D canadienne n'ont pas été orientées vers la priorité de la défense, ils puissent profiter de leur expertise pour commercialiser diverses innovations et de ce fait pénétrer des marchés américains. La performance des industries canadiennes de l'acier, des métaux fabriqués, des machines-outils, pourrait donc être supérieure à celle des mêmes industries aux États-Unis.

D'autre part, Markusen prétend que le changement dans la localisation géographique de la production du "heartland" industriel vers le périmètre de la défense aura un effet négatif sur la croissance des importations américaines provenant du Canada relativement à celles de l'Asie.

Elle signale que la demande induite de biens et services a augmenté à un rythme plus bas dans les régions américaines qui sont les plus près du complexe industriel canadien du Québec et de l'Ontario.

Un examen des données d'importations américaines en provenance du Canada entre 1980 et 1985 indique que c'est dans le domaine des biens de production et des biens de consommation durable que les exportations du Canada ont le plus augmenté. En effet, c'est dans les métaux, la machinerie, et les équipements de transport, que la part des exportations canadiennes a le plus augmenté, et non pas dans les domaines reliés à la défense ou à la haute technologie. Il n'y aurait que les télécommunications et l'avionnerie canadienne qui pourraient profiter indirectement de cette augmentation dans les dépenses militaires américaines. Leur croissance dans les exportations a été moindre que celle observée dans les biens de production et de consommation durable.

La part des exportations des télécommunications canadiennes dans l'ensemble des importations de télécommunications américaines a diminué durant cette période. Dans le domaine de l'avionnerie et des pièces, la performance canadienne a été légèrement meilleure mais pas significative.

Selon Markusen, ce sont les sous-contracteurs du Canada qui se tireront le mieux d'affaire dans les exportations vers les États-Unis, plutôt que des assembleurs et des producteurs de composantes majeures.

Du côté des biens de technologie, environ 17% des exportations américaines vers le Canada tombent dans cette catégorie, alors que seulement 7% des importations américaines du Canada s'y trouvent.

La balance commerciale a été favorable aux États-Unis et ceci, en partie, à cause de l'effet des dépenses militaires.

Markusen mentionne qu'une part beaucoup plus considérable de la croissance des exportations de produits manufacturiers du Canada vers les États-Unis a été dans le domaine de l'automobile, responsable de 33% des exportations canadiennes vers les États-Unis et de 40% des importations américaines de véhicules moteurs.

Il semblerait que les exportations de biens de capitaux, soit "high tech" soit "low tech", ne réussissent pas très bien, quel que soit le taux de change.

Elle trouve frappant le fait que les industries canadiennes non reliées à la défense aient eu une performance définitivement meilleure que celles reliées à la défense dans leurs exportations vers les États-Unis de 1981 à 1985.

Ceci porte à conclure que la politique de la défense américaine n'a pas eu d'impact positif sur les exportations canadiennes.

En partie, ceci serait dû au Pacte de l'auto versus les politiques de "Buy America", et au changement dans la composition de la demande orientée par les militaires vers la haute technologie plutôt que la machinerie et les "intrants" d'acier, d'aluminium, etc.

Les producteurs canadiens auraient perdu, tout comme les producteurs manufacturiers du mid-west américain.

Il semblerait aussi, selon Markusen, que le Canada n'a pas pu, comme le Japon, prendre des innovations reliées à la défense et faire des applications pour améliorer les machines outils et la machinerie industrielle d'une nouvelle génération d'équipement de haute technologie.

Selon Markusen, une réaction possible de la part du Canada serait donc de tenter de faire libéraliser les achats dans le domaine des produits reliés à la défense et de favoriser des "joint ventures" canado-américains dans les domaines influencés par la politique de la défense. Elle ne croit cependant pas que le Canada puisse réussir à faire libéraliser le commerce relié à la défense entre les deux pays.

Selon Markusen, il serait indiqué pour les deux pays de comprendre mieux les raisons de leur pauvre performance sur le plan international dans les biens durables et les biens de production civils.

Conference Papers

I.

An Historical Overview of Canada-U.S. Trade Relations

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Introduction

The United States and Canada have by far the largest bilateral trading relationship in the world, with the volume of trade in 1985 surpassing US $120 billion. The American market is the recipient of more than three quarters of all Canadian exports, whereas the United States, which sends one fifth of its total exports to Canada, actually exports more to Ontario than to Japan, and more to British Columbia than to China. The United States and Canada also rank respectively as the number one and two host nations in the world for foreign direct investment, with U.S. citizens and companies the dominant investors in Canada and Canadians ranking as the fourth largest investors in the U.S. market.

These two North American nations are now engaged in comprehensive free-trade discussions with both sides hoping that the trading relationship will continue to expand. The purpose of this paper is to explore from an historical vantage point some of the issues and trends which are likely to have an impact on the current trade discussions. In addition, both nations face significant challenges linked to increasing global economic interdependence, challenges which are bound to influence the future course of bilateral trade relations. Some of these special challenges will also be examined in this paper.

The Evolution of Canada-U.S. Trade Relations

The Post-Revolutionary Period

Many supporters of the U.S. Revolution believed that it was inevitable that the people in the northern colonies would eventually join the United States of America. Two groups of American revolutionaries invaded the St. Lawrence valley in the latter part of 1775, several months before the Declaration of Independence was signed in Philadelphia. These soldiers thought that the French-speaking citizens of what had formerly been New France would eagerly jump on the revolutionary bandwagon. However, the disrespect shown by these invading forces for the French-Canadian language, culture, and religion did little to endear them to the hearts of the Quebec citizenry. Moreover, many Quebec residents endorsed the Quebec Act of 1774 and were not in any rush to support English-speaking Americans over the English-speaking Britons from across the Atlantic. Pragmatically, these *Canadiens* preferred neutrality in a war which would pit anglophone against anglophone, even though their former mother country, France, would eventually become a pivotal player in the revolutionary struggle.[1]

For decades after the revolution was fought and won, a good number of U.S. leaders harbored two ambitions: Great Britain out of North America and U.S. expansion to the north. John Adams, who would later become the second president of the United States, warned his cousin Samuel in 1778 that "as long as Great Britain shall have Canada, Nova Scotia, and the Floridas, or any of them, so long will Great Britain be the enemy of the United States."[2] In a speech to Congress two years prior to the outbreak of the War of 1812, Henry Clay of Kentucky insisted that "the conquest of Canada is in your power. I trust I shall not be deemed presumptuous when I state that the militia of Kentucky are alone competent to place Montreal and Upper Canada at your feet."[3] On the eve of the War of 1812, another western congressman, Felix Grundy, pledged that the British would be driven from the continent and that by losing their Canadian trade and having no " resting place" in North America, the British would no longer be capable of "annoying" the United States.[4] Many warhawks in Congress were confident that with Americans outnumbering the residents of British North America by at least 20 to 1, an invasion of Canada would be a relatively simple operation and would represent the easiest and most risk-free strategy for punishing Great Britain for its anti-American activities on the high seas.

As it turned out, the Americans were very fortunate to emerge from the War of 1812 with their territory intact, and suffered the indignity of having their capital city burned and their president in flight.

Tensions between London and a rebuilt Washington eventually subsided and the Anglo-American Treaty of 1818 helped to iron out some of the problems in the 1783 boundary treaty and established the border from the Atlantic to the Rocky Mountains along the 49th parallel.[5]

One should not be left with the impression, however, that leaders in the United States always felt that British North America would have to be conquered by force. Indeed, the first constitution of the United States, known as the Articles of Confederation,

extended a very special invitation to the northern colonies. Article 11 of this constitution which became operative in 1781 stated the following: "Canada acceding to this confederation, and joining in the measures of the United States shall be admitted into and entitled to all the advantages of this union; but no other colony shall be admitted into the same, unless such admission be agreed to by nine states." Thus, the colonies in present-day Canada were to be extended a carte blanche invitation to join the newly-created United States of America, whereas other territories would have to endure a much more rigorous review process before being admitted to the union of states.[6] However, in spite of this special constitutional provision, it was very clear that with the exodus of the embittered United Empire Loyalists northward, it would be impossible for the remaining British colonies to accept the invitation extended by the United States.

The period between the War of 1812 and the Civil War was fairly uneventful in terms of U.S. efforts to bring British North America into the union. When the British terminated the Corn Laws and ended the old preferential trade arrangements between the mother country and its colonies in 1846, the Province of Canada became much more interested in securing access to the growing American market. Eight years of on-again, off-again negotiations took place, characterized by a fair amount of American indifference. Finally, faced with the threat of higher Canadian tariffs and a protracted boundary fisheries dispute, the United States agreed to sign the Elgin-Marcy Reciprocity Treaty of 1854. The treaty was fairly comprehensive and permitted the free exchange of such natural products as fish, animals, butter, cheese, coal, flour, grain, and timber.[7]

The Critical Civil War Period

The Civil War was a very critical period in U.S-Canadian relations, much more so than many historians have noted. British support of the Confederacy early on in this civil conflict provided the Union with a strong rationale for stripping the Province of Canada from the British Empire. The United States enjoyed more than a 10 to 1 population advantage and in sharp contrast to the War of 1812 period, had the largest and best equipped army on earth, with over 800,000 Union soldiers in uniform when hostilities were halted at Appomattox in April 1865.

Moreover, the United States was still enthralled with the notion of "manifest destiny," a term coined in 1845 by John L. O'Sullivan, editor of the *Democratic Review*. O'Sullivan wrote that the United States had the "manifest destiny to overspread the continent allotted by Providence to the free development of our yearly multiplying millions."[8] What were the limits of this manifest destiny? In 1819, John Quincy Adams, who would later occupy the White House, insisted that "the United States and North America are identical."[9] A zealous Indiana congressman would boast in 1846 that the United States was bound to extend from "the Isthmus of Darien to Behring's straits."[10]

This sense of a special mission and destiny went far beyond the realm of mere words and boasts. In 1803, President Jefferson gave Napoleon US $15 million for the Louisiana Territory, a mass of 828,000 square miles extending from the Mississippi to the

Rocky Mountains and from the Gulf of Mexico to British North America. With his ambitious plans for Europe, Napoleon had little use for this faraway territory, showing the same disdain which Louis XV had manifested toward New France in the 1750s. Napoleon also believed that this transaction would affirm "forever the power of the United States" and give "England a maritime rival that sooner or later will lay low her pride."[11]

In the three decades after 1815, the United States was to acquire Florida, Texas, and the Oregon and Mexican Territories, adding 1.3 million square miles to the nation. Also, the U.S. population nearly tripled from 8.5 million in 1815 to 22 million in 1848. In the Mexican War of 1846-48, the United States took by conquest areas which now comprise New Mexico, Arizona, California, Nevada, and Utah. Counting the earlier takeover of Texas and the later Gadsden Purchase of 1853, the United States took control of over one half of Mexico's territory in a span of two decades.

In the aftermath of the cataclysmic Civil War which claimed over 600,000 American lives and cost over US $15 billion, Washington looked northward. In 1867, Russia sold Alaska to the United States for US $7.2 million, adding another 591,000 square miles to U.S. territory, an area twice the size of Texas.

In light of this almost insatiable expansionist thirst, why did the United States refrain from adding Canada to its growing empire? Certainly the British support of the South provided a credible pretext. Moreover, the British had supported the French in the invasion of Mexico in 1863, an action which clearly violated the Monroe Doctrine of 1823. Furthermore, even after the Confederation was formed in 1867, Americans could have made a power play for the territories west of Ontario, especially the rich British Columbian coast that separated the Oregon Territory from the newly acquired Alaskan Territory.

Quite frankly, Americans were war weary, debt ridden, and facing a huge challenge in trying to reconcile differences between the North and the South during the Reconstruction era. Moreover, the assassination of Abraham Lincoln and the turbulent Johnson and Grant presidencies had focused attention on the need to mend fences and promote political and economic stability at home.

Canadians also profited in this instance from being perceived as "just like Americans." A common heritage and similar legal and diplomatic codes had helped smooth the way toward the extension of the 49th parallel to the Pacific in 1846, in spite of the fact that President Polk had initially claimed western territory all the way to the 54th parallel. Polk solved this territorial dispute with Great Britain through diplomatic means. In contrast, Polk was willing to wage war with Mexico in 1846 over another territorial dispute.

These common Anglo-Saxon roots also smoothed the way for the acceptance by the United States of the new Canadian Confederation, even though Americans were disenchanted with British practices. In 1866, Washington did abrogate unilaterally the Elgin-Marcy Reciprocity Treaty, partly out of anger for British behaviour and partly to retaliate for new British North American tariffs on U.S. manufacturing goods. However,

in view of U.S. expansionary practices in North America and its awesome military capability, U.S. actions toward Canada could have easily been much more draconian.

The Confederation and the National Policy

The United States showed little interest in negotiating a new trade agreement with the Canadian Confederation, even though British and Canadian officials tried to resurrect the old Elgin-Marcy accords in 1869, 1871, and again in 1874. Canadian interest in a new trade pact was easy to understand. During the dozen years the reciprocity agreement was operational, Canada had become very reliant on the vast U.S. market and had even changed its currency from the pound to the dollar. In 1874, a draft treaty was finally negotiated which would permit free trade in steel, paper, shoes, furniture, and other wood products, agricultural implements, and a wide range of manufactured goods. The British government, on behalf of Canada, gave its approval to the accord, but the U.S. Senate refused to ratify it.

Sir John A. Macdonald's National Policy of high tariffs and protected industrial development was spawned partially in response to U.S. disinterest in a new trade accord. And even his National Policy permitted the possibility of free trade with the United States in many natural products. In the national election of 1891, the Liberal opposition pushed for unrestricted reciprocity with the United States, but Macdonald's Conservative party won handily.[12] The issue of freer trade was hotly debated, however, for Canada had suffered through a series of economic mishaps and two million Canadians abandoned the country and settled in the United States during the final 30 years of the nineteenth century.

Indeed, during the Depression of 1890 it was popular to say that two books of the Old Testament—Lamentations and Exodus—aptly described the situation in Canada. On the other hand, the United States gave little reason for Canadians to hope for a freer-trade arrangement, and Congress reacted to the 1890 Depression by jacking up U.S. tariffs to near-record levels.

The Reciprocity Crisis of 1911

The second thoughts which many Canadians have traditionally shown toward closer economic integration with the United States were most clearly manifested in the reciprocity controversy of 1911. The Liberal government of Wilfred Laurier had worked out a new reciprocity trade agreement with the United States and sought a public mandate for this action in the election of 1911. In January of that year, a text of a new Canada-U.S. trade agreement was announced in the House of Commons and by President William Howard Taft at the White House. Taft had for 38 years spent part of his summers at Murray Bay on the St. Lawrence and personally believed that Canada-U.S.

economic ties should be enhanced. The 1911 agreement was fairly similar to the 1854 pact, and most U.S. tariffs on manufactured goods were to be reduced, whereas most Canadian manufacturing tariffs would remain in place.[13] The legislation approving the agreement was to be passed in exact form by Parliament and by Congress, and would not be considered as a treaty. This plan would keep Great Britain out of the process and also negate the need for a two-thirds vote in the U.S. Senate, the constitutionally mandated majority required for the ratification of any treaty. In July 1911, the two chambers of the U.S. Congress finally passed the legislation and President Taft signed it into law. In Canada, however, Robert Borden's Conservative Party staunchly opposed the trade legislation and easily defeated Laurier's Liberals in the 1911 election. The new Conservative government never put the reciprocity agreement to a vote, and the U.S. Senate eventually rescinded its 1911 vote eight years later.[14]

The Turbulent 1930s

In response to the deepening economic depression, the U.S. government enacted the infamous Smoot-Hawley Tariff in 1930, raising the average tariff on dutiable goods to a record high 59 per cent. This blatantly protectionist policy certainly limited the shipment of goods into the United States, with imports in 1932 falling back to 1909 levels. On the other hand, the trade war that ensued helped to increase U.S. unemployment to a staggering 25 per cent, and real per capita income retreated to the same level achieved back in 1907. Congress also passed the Buy American Act of 1933, and although no preference levels were mandated, successful foreign bidders were often required to come in with bids at least 25 per cent below those submitted by American contractors.[15]

Franklin D. Roosevelt's entry into the White House in 1933 was to mark a gradual turnaround in Washington's views toward trade protectionism. The Trade Agreements Act of 1934 (also known as the Hull Act) was intended to cut tariffs by up to 50 per cent in return for reciprocity pacts with other major trading nations. Approximately 20 such reciprocity agreements were negotiated by 1939, including two important agreements with Canada in 1935 and 1938. In a passage that reflects Canada's need for access to U.S. markets, Prime Minister Mackenzie King wrote in his diary that the 1935 Canada-U.S. trade pact was "the greatest political accomplishment of my life."[16]

World War II and the Postwar Period

In 1940, the United States and Canada signed the Ogdensburg Agreement which created a Joint Defence Board, and a defence production sharing arrangement was made possible through the 1941 Hyde Park Declaration. In 1944, duties on all agricultural machinery and implements were also removed by the two neighboring countries.

Wartime demands also precipitated greater cooperation on a continental basis. The United States and Mexico appointed a joint defence board and Mexico and Canada became prime sources of raw materials for U.S. factories. In addition, Presidents Roosevelt and Camacho reached an agreement to permit Mexican braceros to work on U.S. farms in the southwest, and this agreement was expanded in 1943 to include non-agricultural workers.

Two years after the war ended, the governments of Mackenzie King and Harry Truman commenced private negotiations on a new Canada-U.S. free-trade agreement, an arrangement which at the time would have facilitated closer economic ties between the two most affluent nations on earth. The United States offered a large number of trade concessions, and in the era of the Marshall Plan and massive U.S. economic assistance to Western Europe and Japan, it is highly likely that the U.S. Senate would have ratified the pact.[17] The Canadian prime minister, who had initially given approval for the trade discussions in October 1947, vetoed the draft and the negotiations were ended in May 1948. Mackenzie King feared that the Canadian public would label the pact as continentalist and anti-British, and he was not prepared to face the political heat.

Through the multilateral process initiated by the General Agreement on Tariffs and Trade (GATT), both nations agreed to trade liberalization in the postwar period. Trade flows north and south were enhanced, with an important boost provided by the Canadian-U.S. Automotive Products Trade Agreement (the auto pact). This bilateral arrangement signed by Lyndon Johnson and Lester Pearson in January 1965 permits free trade in original equipment parts and vehicles. Canada has also been provided with certain safeguards and trade and investment guarantees. The impact of the auto pact on bilateral trade has been immense. For example, in 1984, Canada's leading export to the United States was motor vehicles and parts, valued at US $21.5 billion. Canada's second leading export was crude petroleum, estimated at US $3.3 billion. The leading U.S. export to Canada was also motor vehicles and parts, valued at US $19.8 billion. The second leading American export to Canada was industrial machinery, with an estimated worth of US $5.0 billion.[18]

The Era of the Third Option, FIRA, and the NEP

Even though bilateral trade volume was increasing, trade-related irritants would eventually cause significant strains in relations between Ottawa and Washington. The Nixon Shock of 1971 placed a 10 per cent surcharge on all dutiable goods, and Canada was not exempted from the order. Because of such damaging U.S. government actions and Canada's great dependency on the U.S. market, the Trudeau administration embraced the Third Option strategy outlined by the federal trade minister Mitchell Sharp in 1972. According to the Third Option, Canada would need to embark on a program to diversify trade and investment links. In a short period of time, trade agreements were initialled with the European Economic Community (EEC) and with Japan. Unfortunately, the fruits of such agreements were never realized, and Canada became more dependent than

ever before on export trade with the United States. In the early 1970s, Canada sent two thirds of its exports to the United States, compared to more than three quarters now.

Officials in Washington reacted warily to a law passed in 1973 which created the Foreign Investment Review Agency (FIRA). Two years later, U.S. criticism grew more intense as Parliament passed legislation to "Canadianize" *Time* and *Reader's Digest*. The Canadian government also eliminated the tax write-offs for Canadian companies which advertised on U.S. television stations situated along the border. Moreover, the Canadian Radio-television and Telecommunications Commission (CRTC) consistently pushed for its own domestic version of the Third Option, advocating far greater Canadian content in television and radio programming.

In retaliation for the Canadian policy towards advertising on U.S. border stations, Congress invoked for a time tax restrictions to discourage American groups from holding conventions in Canada, an action which cost Canadian businesses far more than the fees lost by a relatively small number of American TV stations. In February 1979, the U.S. government also took the controversial step of imposing a countervailing duty on the importation of Honeywell optical sensing systems produced in Canada, claiming that research and development for the product had been subsidized by the Canadian government. Canadian officials in turn complained that the U.S. government was involved in the subsidization of research and development to a far greater extent than the Canadian government. Ottawa also pointed out that trade barriers were being erected rather ominously at both the federal and state governmental levels through the proliferation of Buy American laws.

The bilateral relationship deteriorated further in 1981 with the introduction by the Trudeau government of the National Energy Policy (NEP) and a strengthened FIRA. With the advent of the Reagan administration, John Holmes warned that Canadians "face not only competition with American industry but also an ideological confrontation with born-again free enterprise."[19] Stephen Clarkson added that the bilateral relationship was subject to topsy-turvy twists. He contended that in 1980 Canadians were viewed in Washington as the "heroes of the Western world" for rescuing six U.S. diplomats from Iran, but only a year later, in the wake of the NEP and FIRA pronouncements, were caricatured in the United States "as the hordes of Genghis Khan descending from the north to plunder innocent American enterprise."[20] And indeed, during the height of the investment controversy, U.S. publishing magnate Walter Annenberg took out a full-page advertisement in the *Washington Post* using as his headline, "Canada's Unfairness Doctrine."[21]

The Era of Sectoral and Comprehensive Free Trade

The bilateral economic relationship passed its crisis point in late 1982 or early 1983. Faced with serious economic problems linked to the worldwide recession, the Trudeau government relaxed its NEP and FIRA regulations. Business and trade expansion were to be major priorities during the last months of the Trudeau administration, and a trade

document was released which, surprisingly, expressed Canada's willingness to explore sectoral free-trade arrangements with the United States.[22] For its part, the Reagan administration cooled down its rhetoric and reacted positively to the overture for informal trade discussions. These discussions on sectoral trade began in Washington in December 1983.

Following the landslide victory of Brian Mulroney and his Conservative party in 1984, the bilateral agenda eventually shifted away from the sectoral approach and toward an exploration of a comprehensive free-trade accord. In September 1985, the Mulroney government formally committed itself to enter into negotiations with the United States, and these negotiations commenced in May 1986.[23] The agenda-setting first phase of the discussions were concluded in September 1986, and lengthy item-by-item discussions are now under way. The big question which remains is whether these negotiations will suffer the same fate as the discussions of 1910-11 and 1947-48.

Canada-U.S. Free Trade: The Issue in Perspective

Free Trade and Historical Lessons

What insights are provided in the evolution of Canada-U.S. trade relations that might shed light on the eventual outcome of the current free-trade negotiations? The following are important points to consider:

1. Canada has always initiated the free-trade discussions.
2. The United States has generally shown a fair amount of indifference towards such discussions, with the major exception being President Taft's personal interest in the 1911 pact.
3. Generally, once negotiations have commenced, Canada tends to have second thoughts about a bilateral free-trade pact and eventually terminates the negotiations.
4. The U.S. Senate has at times been a formidable obstacle standing in the way of closer economic ties between the two nations, as exemplified by its veto of the 1874 trade pact and the East Coast Fisheries Treaty in 1981.
5. The United States unilaterally abrogated the only bilateral freer-trade pact that ever existed, namely the Elgin-Marcy Reciprocity Treaty of 1854.
6. When economic times get tough, Canada usually attempts to improve its access to American markets, whereas the United States tends to turn inward and to become much more protectionist in its trade policies.

Certainly, the Canadian tendency to initiate discussions and then to have second thoughts about a free-trade arrangement has the most important implications for the current negotiations. Many Canadians continue to fear that a free-trade arrangement

with the United States would limit Canadian sovereignty and facilitate closer economic and political integration. This apprehension may well be the chief stumbling block to the conclusion of a comprehensive free-trade accord. In effect, Ottawa tends to initiate trade discussions with Washington during times of economic malaise, and then backs off once a pact has been negotiated (specifically 1911 and 1948). With new national elections expected within two years, it is quite possible that the Mulroney government will back off from the free-trade issue and either end the talks altogether or agree to an accord which only modestly differs from the current trading relationship.

U.S. indifference could provide the Conservative government with an easy excuse either to exit prematurely from the talks or to arrange a modest accord. Certainly, Ronald Reagan would like to see some sort of pact signed between Washington and Ottawa, but he is not the reincarnation of William Howard Taft. The U.S. negotiating team directed by Peter Murphy has not been pressured by the Reagan administration to secure a comprehensive trade accord. Indeed, the U.S. side is content to have Simon Reisman's group initiate most of the agenda items. To be quite frank, it will be the Canadian government which will have the greatest voice in deciding just how comprehensive any bilateral trade agreement will be.

Will the U.S. Senate prove to be a nemesis if Reagan and Mulroney do reach an agreement? The U.S. constitution stipulates that the Senate must approve any treaty by a two-thirds majority. In order to gain the necessary 67 votes in the Senate, President Carter had to make major concessions to Senate conservatives and moderates before garnering enough support to ratify the Panama Canal treaties. Canadians also remember with less than fond memories what a group of New England senators was able to do to the fisheries treaty. Could the same problems arise with a Canada-U.S. free-trade pact?

Probably not. The new fast-track system which is in place greatly increases the chances that the U.S. Congress will approve any pact negotiated by the neighbouring governments even though the Republicans control the White House and the Democrats control both houses of Congress. For one thing, the pact will not be a formal treaty and thus will not require a two-thirds vote in the Senate. Instead, both the Senate and House of Representatives will be asked to provide majority support for the proposal. In addition, fast-track rules ensure that neither chamber will be able to attach amendments to the proposal. The senators and representatives will face a simple take-it-or-leave-it vote. If an agreement can be reached by January 3, 1988, the U.S. Congress will have 60 legislative days to accept or reject the pact. This fast-track system was first used with the U.S.-Israeli free-trade accord implemented in 1985 and greatly simplifies the congressional ratification process.

As for the abrogation issue, the U.S. termination of the 1854 pact occurred under very unusual circumstances and has little relevance for the 1980s. Moreover, although Washington has been somewhat disturbed by the recent trade imbalances in the auto pact, it has not given serious consideration to abrogating this agreement which has been in force for over 20 years, even though either side can terminate the pact unilaterally with one year's notice.

The historical lessons to be learned from how the two nations react to economic downturns should also be taken to heart by the trade negotiators. When economic conditions deteriorate, the United States tends to turn inward, whereas Canada looks for greater access to the U.S. market in order to spur on economic development and the creation of new jobs. As will be discussed in the next section, the United States may now be facing some of the most difficult economic challenges in its history, and protectionist sentiments, particularly in those states with traditional manufacturing or resource-based industries, are growing dramatically. Without a free-trade accord, will Canada risk losing some of its access to the U.S. marketplace? The answer is definitely yes.

The Interdependence and Vulnerability Issues

Both nations can be winners or losers depending on the outcome of the free-trade discussions, but without any doubt Canada will be the biggest winner or loser.

In an increasingly complex and interdependent global economic system, no major nation on earth is more vulnerable to American protectionism than Canada. When Washington ended the first trade pact in the 1860s, only 40 per cent of Canadian exports headed south of the border; today, the percentage is almost twice as great.[24] Without some form of assured access to the vast American marketplace, the major victim of a protectionist war pitting the United States against Japan or the EEC will be Canada.

Because of this vulnerability, some observers contend that Canada must revive the Third Option. But as discussed earlier, the first go-around with the Third Option produced trade agreements with the EEC and Japan, but little in the way of trade diversification. Moreover, export trade with Asia and much of Europe will be predominantly in the form of raw materials, whereas the United States accepts the great bulk of all Canadian manufactured goods. Trade diversification is important for Canada, but only if it expands overall export trade and provides new markets for manufactured end products. Certainly, a bilateral trade agreement with the United States and trade diversification are mutually beneficial goals for Canada.

Other observers might say that the GATT multilateral approach is sufficient to break down North American trade barriers. Quite frankly, the multilateral route presents fewer political risks for the Canadian government than the bilateral path. In addition, the GATT approach has significantly lowered duties. By the time the Tokyo Round is fully implemented in 1987, the average tariff on dutiable goods moving from Canada to the United States will be 5 per cent, and the average in the opposite direction will be 9 per cent.

On the other hand, the new Uruguay Round is heading into uncharted waters which might prove to be quite perilous. Agricultural and services trade, subsidies, investments, government procurement practices, and intellectual property protection are among the extremely difficult issues to be discussed. The talks will certainly drag on for years and only incremental gains will be made in some of these thorny issues. Instead of

relying solely on GATT to bring about liberalized trade in North America, the United States and Canada should have as their shared goal the ratification of a bilateral pact which will serve as a prototype for future GATT discussions.

Canadians must also recognize that just as they feel vulnerable in their trading relationship with their southern neighbour, so are Americans feeling more vulnerable in an increasingly interdependent world. The United States is now far and away the number one host nation on earth for foreign direct investment, with such investment increasing from US $13 billion in 1970 to US $183 billion in 1985. Approximately three million Americans now work for foreign-controlled enterprises on U.S. soil.

Furthermore, in absolute dollar terms, the United States has the largest trade deficit in history and is headed toward a record annual deficit of US $170 billion in 1986. Imports continue to expand while U.S. merchandise exports as a percentage of gross national product (GNP) have declined precipitously. Both in the trade and the much more important current-account categories, the short-term outlook for the United States is bleak.

Add to this gloomy picture an aggregate government deficit of two trillion dollars. In spite of Gramm-Rudman and tax reform, the government deficit will continue to grow with annual interest payments on this debt reaching US $160 billion in 1988. The United States also ranks as the number one debtor country in the world, with Americans having a net foreign debt of US $107 billion in 1985. Although this debt as a percentage of GNP is much smaller (3 per cent) than that of Mexico (55 per cent) or Brazil (48 per cent), it will continue to increase through the remainder of the decade, adding to the nation's debt-servicing burden.

As a result of these economic problems which are often blamed, whether rightly or wrongly, on unfair trading conditions, protectionist sentiments in the 100th Congress, which will convene in January 1987, may be stronger than at any time since 1933. Contingency protection measures are also increasing within the executive agencies of the U.S. government. Without a bilateral free-trade agreement providing some form of assured access to the expansive American marketplace, Canada should expect that U.S. protectionist actions taken recently against cedar shakes and softwood lumber will be applied to other sectors as well.

And finally, history has taught that loose cannons on both sides of the border can impair progress in free-trade discussions. In the 1910-11 discussions, Champ Clark made statements in Congress that were deeply resented by Canadians. A *Time* article stating that "Canada has become an economic 49th state" certainly did not assuage some of the fears of Mackenzie King during the 1947-48 discussions.[25] A few U.S. bureaucrats who know little about Canada have made some flippant statements during the current round of negotiations. On the Canadian side of the border, some politicians and commentators opposed to free trade have warned that closer economic ties might subject Canada to an epidemic of American crime and inner city turmoil, rhetoric which was used almost verbatim during the 1911 debate.[26] It is difficult to see how these issues are interconnected. Furthermore, intimations that Canada will somehow be corrupted or

tainted by signing a free-trade accord with the United States are patently offensive to Americans.

Conclusion

The negotiating teams involved in the current free-trade discussions can learn several lessons from the evolution of Canada-U.S. trade relations. They must also comprehend, however, that challenges linked to growing international economic competition and interdependence will have a strong influence on the future course of bilateral trading ties. In purely economic terms, a free-trade pact is desirable and would help both nations to rationalize their economic structures in order to compete more effectively against other major trading countries.

Unfortunately, history teaches that significant political and public opposition in Canada, combined with a proliferation of protectionist activities in the United States, will make a comprehensive accord difficult to achieve. In light of its dependency on exports for economic growth and its heavy reliance on a single foreign market, Canada risks being the major loser if the current bilateral negotiations falter.

Notes

1. For an excellent background report on this period of history, see G. A. Rawlyk, *The 'Rising American Empire' and Canada: From John Winthrop to Ronald Reagan*, paper presented at the Conference of the University Consortium for Research on North America, Tufts University, October 10-12, 1986.
2. Robert H. Divine, ed., *American Foreign Policy: A Documentary History* (New York: Meridian Books, 1960), p. 29.
3. *Ibid.*, p. 50.
4. *Ibid.*, p. 53.
5. For further details on the boundary agreements, see Edelgard E. Mahant and Graeme S. Mount, *An Introduction to Canadian-American Relations* (Toronto: Methuen, 1984), pp. 29-34.
6. For a discussion of this first U.S. constitution, see Merrill Jensen, *The Articles of Confederation* (Madison: University of Wisconsin Press, 1963).
7. See Simon S. Reisman, "The Issue of Free Trade," in Edward. R. Fried and Philip H. Trezise, eds., *U.S.-Canadian Economic Relations: Next Steps?* (Washington, D.C.: The Brookings Institution, 1984), pp. 35-36.
8. Thomas G. Paterson, J. Garry Clifford, Kenneth J. Hagan, *American Foreign Policy*, vol. 1, 2nd edition (Lexington, Mass.: D.C. Heath, 1983), p. 87.
9. *Ibid.*
10. *Ibid.*
11. *Ibid.*, p. 60.

12. See Reisman, p. 37.
13. See Richard Gwyn, *The 49th Paradox* (Toronto: McClelland and Stewart, 1985), pp. 36-37.
14. Two good sources of information on the 1911 episode are Mahant and Graeme, pp. 92-98, and Lawrence Martin, *The Presidents and the Prime Ministers* (Toronto: Doubleday Canada, 1982). In particular, Martin gives an excellent account of the Laurier Taft-Champ Clark reciprocity battle.
15. See Congressional Quarterly, *Trade: U.S. Policy Since 1945* (Washington, D.C.: Congressional Quarterly, 1984), p. 40.
16. Quoted in Gwyn, p. 50.
17. The draft outline of the free-trade pact is found in ibid, pp. 337-340.
18. *Barron's*, November 18, 1985.
19. John W. Holmes, *Life with Uncle: The Canadian-American Relationship* (Toronto: University of Toronto Press, 1981), p. 60.
20. Stephen Clarkson, *Canada and the Reagan Challenge: Crisis in the Canadian-American Relationship* (Toronto: Canadian Institute for Economic Policy, 1982), p. 28.
21. This episode is discussed in *Maclean's*, October 25, 1982, p. 38.
22. Government of Canada, Department of External Affairs, *Canadian Trade Policy for the 1980s: A Discussion Paper* (Ottawa: Minister of Supply and Services, 1983).
23. For a look at the Mulroney government's initial trade position, see Government of Canada, Department of External Affairs, *Canadian Trade Negotiations: Introduction, Selected Documents, Further Readings* (Ottawa: Minister of Supply and Services, 1986).
24. See Bruce W. Wilkinson, "Bilateral Free Trade with the United States," in D. H. Flaherty and W. R. McKercher, eds., *Southern Exposure: Canadian Perspectives on the United States* (Toronto: McGraw-Hill Ryerson, 1986), p. 97.
25. See Gwyn, p. 53.
26. An historical look at Canadian stereotypes concerning American degeneracy, godlessness, corruption, and racism is provided in G. A. Rawlyk, *Canadian-U.S. Relations: An Historical Probe from the East*, paper presented at the Conference of the University Consortium for Research on North America, Tufts University, October 10-12, 1986.

II.

Potential Impact of a Bilateral Free(r) Trade Agreement on U.S. Direct Investment in Canadian Manufacturing

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I. Introduction

> *"Geography and history have made it inevitable that the economic structures of Canada and the United States should become closely intertwined."*
>
> Herbert Marshall, Frank Southhard, Jr., Kenneth W. Taylor, *Canadian-American Industry* (1936), p. 1.

In September 1985 Canada and the United States began considering a comprehensive bilateral free(r) trade agreement (FTA), following a formal request by Prime Minister Brian Mulroney. [Mr. Mulroney and his ministers are reluctant, perhaps for political reasons, to speak of "free" trade, preferring "freer" trade.] The FTA negotiations between the two countries, which started in May 1986, are continuing. It is too early to tell when these complex negotiations will end and how successful they will be.

There is more than a century-long history of recurrent and mostly unsuccessful attempts to liberalize Canadian–U.S. trade (Morici, 1985), which should temper any excessive optimism about the outcome of the present one. The last attempt to negotiate a comprehensive FTA was made in 1948. The first public Canadian initiative for the present one was taken by the Senate standing committee on foreign affairs in its report of March 1982 on *Canada's Trade Relations with the United States*. (Wonnacott, 1982, analyzes the early controversy in Canada surrounding the present attempt to reach an FTA.)

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The United States has been receptive to FTA since the Congress required, in the Trade Agreements Act of 1979, the president to explore it. President Reagan in his 1980 campaign proposed a "North American Accord," indicating an interest in FTA. [Hufbauer and Samet (1983 and 1985) discuss the earlier U.S. official and private attitudes and responses to primarily sectoral bilateral trade liberalization initiatives.] The Trade and Tariff Act of 1984 gave the president an explicit mandate to negotiate for an FTA with Canada as well as other countries.

Almost everyone agrees that the current negotiations did not make an auspicious start amid the shakes and shingles (cedar wood building products) dispute, which started a trade skirmish. At present, the softwood-lumber controversy casts a dark shadow over the negotiations, as the two countries are at loggerheads over alleged Canadian subsidies. Moreover, in both countries, especially in Canada, the FTA talks are opposed by powerful special interest groups.

Finally, the fate of FTA hangs more on dismantling the myriad non-tariff barriers (NTBs) than on reducing the already relatively low tariffs. The former are notoriously tougher to negotiate down than the latter. In many cases, defining what is and what is not an NTB itself is a contentious issue.

After the latest tariff reductions, scheduled under the Tokyo Round of the General Agreement on Tariffs and Trade, are made in January 1987, more than 80 per cent of Canadian exports to the United States and 60 per cent of U.S. exports to Canada will be duty free. Canadian and U.S. tariffs on manufactures will average 9 to 10 per cent and 4 to 5 per cent respectively. Tariffs on some products, however, will remain significant obstacles (National Foreign Trade Council, 1986, p. 3).

Although considerable uncertainty exists about the signing as well as the content of an FTA, recently there has been much speculation on its potential impact on U.S. direct investment in Canada, especially in Canadian manufacturing. (Daly and MacCharles—1986, ch. 1-2—analyze the importance of manufacturing in the Canadian economy, especially its greater potential role in foreign trade. They emphasize high costs and low productivity as the primary constraints on exports of manufacturing.) Understandably, almost all of this speculation has taken place among Canadian observers. This paper contributes to that speculation from the U.S. perspective, reflecting largely the views of U.S. multinationals that have manufacturing operations in Canada. (Clearly, an FTA would also have an impact on Canadian direct investment in the United States. These mutual potential impacts should be analyzed jointly in a study broader and more complete than this one.)

The paper is organized as follows: Section II reviews the bilateral trade and direct investment relations in manufacturing. Its primary aim is to reveal the importance of U.S. multinationals in that trade, arising from the linkages between their operations across the border. Section III considers the potential impact of an FTA on U.S. direct investment in Canadian manufacturing in terms of economic theory and reviews the empirical evidence offered by others concerning the nature of that impact. Section IV reports the results of an informal survey, which I conducted for this paper, of 28 U.S.

multinationals in order to reflect their views on the potential impact. Section V ends the paper with summary and conclusions.

II. Bilateral Trade and Direct Investment in Manufacturing

1. Bilateral Trade

Canada and the United States account for the largest bilateral trade flow in the world. The bilateral total merchandise trade (exports and imports) amounted to US $116.7 billion in 1985, up by 51 per cent from US $77.4 billion in 1980 (Tucker, 1986). Canada accounts for 25 per cent of total U.S. exports and 19 per cent of imports. Especially the export share has risen significantly since 1980. The United States, however, accounts for 79 per cent of Canada's exports and 72 per cent of its imports.

In the 1970s, Canadian governments tried but failed to diversify Canada's trade away from the United States (Rugman, 1986a, pp. 9-11). The Third Option adopted by the Trudeau government in 1972, which aimed at strengthening Canada's ties with Western Europe, Japan and the Pacific Rim countries, proved difficult to implement against commercial realities (Riekhoff *et al.*, 1979, pp. 104-105). (The Third Option might have been partly motivated by the Nixon Doctrine, which declared in 1972 that Canada and the United States should "move beyond the sentimental rhetoric of the past" and look after their own interests—Brimelow, 1986, p. 111.)

During the last six years, Canada's trade dependence on the United States for its exports has in fact grown markedly. [Canadian constant-dollar exports to the United States have increased sharply but to the rest of the world have stagnated (*The Economist*, 1986, p. 14).] That fact, coupled with Canada's concern about security of access to the U.S. markets, largely explains the Canadian interest in exploring a comprehensive bilateral FTA with the United States (Report of the Royal Commission on the Economic Union and Development Prospects for Canada, 1985, Vol. I, pp. 323-327). A related important objective is to improve the international competitiveness of Canadian manufacturing, as Canada's continued dependence on natural resource-based economic growth appears to lack long-term promise (Morici, 1984, p. 14 and pp. 78-79; Daly and MacCharles, 1986, pp. 5-6 and pp. 127-129).

Willingly or unwillingly, Canada now wishes to abandon its 107-year-old National Policy (1879) of import-substitution and economic diversification in favor of greater specialization and much closer commercial integration with the United States. This fundamental policy change was encouraged by the Report of the Royal Commission on the Economic Union and Development Prospects for Canada (Macdonald commission), issued in September 1985 after a very broad and in-depth three-year study. The commission was headed by the former Liberal finance minister Donald S. Macdonald, who, like Prime Minister Mulroney himself, once had opposed free trade with the United States. Since 1980 the trade balance has been increasingly in Canada's favour, reaching US $22.2 billion in 1985. (According to reconciled Canadian and U.S. statistics, however, the

deficit was US $15.7 billion, primarily due to unreported U.S. exports.) This bilateral trade deficit for the United States, 16.4 per cent of its total trade deficit, was exceeded only by its bilateral deficit with Japan, which was US $47.2 billion in 1985, 34.9 per cent of the total.

Manufactures have accounted on the average for 87 per cent of the U.S. bilateral exports and 70 per cent of the imports during 1980-85. In the same period, Canada's share of U.S. manufactured exports jumped from 18 per cent to 26 per cent; its share of U.S. manufactured imports, on the other hand, rose from 16 per cent to 19 per cent. Automotive products have averaged 36 per cent of the U.S. bilateral manufactured exports but 47 per cent of the imports.

The bilateral balance has been increasingly in Canada's favour in both total manufactures and automotive products since 1982. The United States has maintained, however, a favourable bilateral balance in high-technology products since 1980. These products have averaged 17 per cent of the U.S. bilateral manufactured exports but 10 per cent of the imports.

The bilateral trade in manufactures has been dominated by automotive products, that is, motor vehicles and original parts (including engines) covered by the Automotive Products Trade Agreement (APTA). The evolution of APTA—the auto pact—has been documented by Beign (1970, pp. 33-50) and Morici *et al.* (1982, pp. 99-102). Since the auto pact was signed in 1965, the bilateral automotive trade leaped from only US $700 million to US $42.2 billion. During 1980-85, the U.S. bilateral automotive exports almost doubled to US $17.5 billion but the imports almost trebled to US $24.7 billion. As a result, the automotive products industry recently accounted for about 10 per cent of total shipments and 6 per cent of direct employment in Canadian manufacturing. It also purchased as inputs substantial proportions of the outputs of several other manufacturing sectors (Government of Canada, 1983, pp. 101-102).

The bulk of U.S. automotive exports, consisting of parts, return to the United States as imports after they are further processed or assembled in Canada, primarily by the subsidiaries of U.S. multinationals. During 1980-85, the annual U.S. bilateral exports of passenger cars increased slightly from about 500,000 units to 700,000 units, but the imports doubled from about 600,000 units to about 1.2 million units (Tucker, 1986, p. 7).

The auto pact has enlarged the bilateral automotive trade beyond initial expectations. In 1985 (versus 1965), Canada exported 1,556,050 (versus 48,000) vehicles (cars, trucks and buses) to the United States, which amounted to 12.9 (versus 0.5) per cent of the U.S. sales of North American manufactured vehicles and 81 (versus 6) per cent of Canadian production. In 1985 (versus 1965), the United States exported 833,449 (versus 64,000) vehicles to Canada, which amounted to 73 (versus 8.5) per cent of the Canadian sales of North American manufactured vehicles and 7.3 (versus 0.6) per cent of U.S. production (Hanna, 1986).

> Prior to the Auto Pact, Canadian vehicle assemblers produced a wide range of models in relatively small numbers for the domestic market. This situation, along with high protective tariffs, led to high consumer prices

> relative to the American market place. The Auto Pact . . . served to rationalize the production of Canadian and U.S. vehicles . . . despite some shortcomings has had a positive effect for both countries. It has enabled U.S. automotive companies to maintain a dominant share of the Canadian market while bringing more production, expanded trade, increased productivity, a larger share of industry employment and lower consumer prices to Canada (Government of Canada, 1985, p. 19).

2. *Bilateral Direct Investment*

Direct foreign investment (DFI) refers to foreign ownership with managerial control of production facilities, that is, real assets. It thus differs from portfolio foreign investment (PFI) which refers to foreign ownership of financial assets without managerial control. DFI, which is undertaken primarily by multinational corporations (MNCs), is not restricted, like PFI, to international movements of financial capital only. Often it also involves cross-border but intrafirm transfers of physical capital as well as other non-financial resources such as technology and management.

Canada and the United States are important partners of each other in not only trade but also DFI. Their unique and close DFI partnership "has its roots far back in the nineteenth century" (Marshall, *et al.*, 1936, p. 4). The recent dimensions of this partnership are examined below.

At the end of 1985, the United States had both the world's largest outward and inward DFI positions, US $232.7 billion and US $183.0 billion, respectively (U.S. Department of Commerce, 1986). (Outward/inward DFI position is the book value of the U.S./foreign direct investors' equity in, and net outstanding loans to, their foreign/U.S. affiliates. A U.S./foreign affiliate is a business enterprise in which a single U.S./foreign investor owns or controls, directly or indirectly, at least 10 per cent of the voting securities, or the equivalent. Book values tend to understate the current replacement values of assets. The older the assets the more serious the under-valuation is likely to be.)

Since 1980, the U.S. outward position has shown little increase. The U.S. inward position, however, has expanded significantly. The opposite has happened in Canada since 1975 (Rugman and Tilley, 1986b; Burgess, 1986, p.27). The ratio of U.S. outward to inward DFI position declined from 4.22 in 1977 to 2.60 in 1980 to 1.27 in 1985. However, the ratio of Canadian outward to inward DFI position rose from 0.34 in 1978 to 0.49 in 1981 to 0.50 in 1984 (Burgess, 1986, p. 27). Recently then, the overall relative source-country versus host-country roles of the United States and Canada have changed in opposite directions, with the former replacing the latter as the country with the largest absolute inward DFI stock in the world.

Canada, whose share of the U.S. outward DFI position trended downward from 35 per cent in 1960 to 20 per cent in 1981 but increased to 22 per cent in 1985, remains the most important host country for U.S. DFI. Correspondingly, the United States is by far

the dominant source country of Canada's inward DFI position, although its share has trended downward from 82 per cent to 76 per cent during 1960-84.

Although Canada's share of the U.S. inward DFI position dropped from 28 per cent in 1960 to 9 per cent in 1985, the share of the United States in Canadian outward DFI position rose from 66 per cent to 72 per cent during 1960-84 (Rugman, 1986a, p. 13). According to Rugman and Tilley (1986a, p. 2 and 1986b, pp. 12-14), during 1975-1984, the bilateral Canada-U.S. DFI positions ratio rose from 0.19 to 0.48. They provide several reasons for this development, especially in terms of the "pull" and "push" factors that have stimulated Canadian DFI in the United States. They also argue, as do Daly and MacCharles (1986, pp. 56-58), that some of the factors that may have discouraged U.S. DFI in Canada may have also encouraged Canadian DFI in the United States.

In short, in terms of their DFI positions, the United States is Canada's most important both source and host country, and Canada is the United States most important host country. In this bilateral DFI relationship, public attention, especially in Canada, has focused almost entirely on U.S. DFI in Canada. This, like many other bilateral matters, may be explained largely in terms of the fundamental asymmetry in the relative economic sizes of the two countries (Rugman and McIlveen, 1986, p. 291). The U.S. economy is often said to be at least ten times bigger than the Canadian economy. Canadian attitudes on this matter, for economic as well as other reasons, have been complex and somewhat ambivalent over many decades (Marshall, *et al.*, 1936, pp. 279-295; Riekhoff, *et al.*, 1979, pp. 83-88; Rugman and Tilley, 1986b, pp. 3-7).

Actually, during 1974-1984, the extent of foreign ownership, as percentage of capital employed, in the Canadian economy decreased significantly. In manufacturing, total foreign (versus U.S.) ownership declined from 57 (versus 43) per cent in 1974 to 51 (versus 39) per cent in 1979 and 49 (versus 38) per cent in 1982 (*The Economist*, 1986, p. 16). These changes may have been related to Canadian policies of economic nationalism during that period, especially the Foreign Investment Review Act of 1973, which established the Foreign Investment Review Agency (FIRA) in 1974 (Globerman, 1979, Part II), and the National Energy Program of 1980 (Hufbauer and Samet, 1980; Bale, 1985, pp. 216-220; Leyton-Brown, 1985, ch. 3).

According to Wolf (1986, p. 21), in 1983, the percentage distributions of four financial measures by foreign control in Canadian manufacturing were as follows:

	U.S.	Non-U.S.	Total Foreign
Assets	31.58	12.94	44.52
Equity	41.35	13.48	54.83
Sales	40.40	9.92	50.32
Profits	58.69	6.54	65.23

Manufacturing accounted for 41 per cent of the total U.S. outward DFI position but 48 per cent of the U.S. DFI in Canada at the end of 1985. On the other hand, manufacturing accounted for 33 per cent of total U.S. inward DFI position and 31 per cent of the Canadian DFI in the United States (U.S. Department of Commerce, 1986). Thus, we see that the shares of manufacturing in the U.S. outward and inward DFI positions

vis-à-vis Canada were significantly lower than its shares in the bilateral trade of the two countries. This can be explained largely by the fact that manufactures are more tradeable than non-manufactures, especially services.

3. *Bilateral Trade and Direct Investment Linkages*

The bilateral manufactures trade was closely linked with the activities of direct investors, especially U.S. MNCs with manufacturing operations on both sides of the border. Attention now turns to the nature and extent of these linkages from the viewpoint of U.S. DFI in Canada. (A broader and more complete study than this one would have to examine the same linkages also from the viewpoint of Canadian DFI in the United States.

These linkages are examined below on the basis of the most recent population-based U.S. Department of Commerce data, that is, the 1982 Benchmark Survey (U.S. Department of Commerce, 1985a) as well as the sample-based Preliminary 1983 Estimates for the Operations of U.S. Parent Companies and Their Foreign Affiliates (U.S. Department of Commerce, 1985b). A comparative analysis for the 1977 and 1982 benchmark years is provided by reference to Barker (1986). "MNC-associated U.S. trade" (here "MNC-trade," for short) equals the merchandise trade flows (1) between (non-bank) U.S. parents and their foreign affiliates plus (2) between foreign affiliates and other U.S. persons plus (3) between (non-bank) U.S. parents and unaffiliated foreigners. MNC-exports decreased from 84 per cent of total U.S. exports in 1977 to 77 per cent in 1982 and 1983. MNC-imports, on the other hand, as a share of total U.S. imports declined from 58 per cent in 1977 to 50 per cent in 1982 and to 46 per cent in 1983. Three reasons may be adduced for the significantly larger export share of U.S. MNCs: They are (1) concentrated in goods production and (2) more export-oriented than uninational firms. Recent research shows that although the share of the United States in world exports has declined significantly during the last two decades, the corresponding share of U.S. MNCs has not (Lipsey and Kravis, 1986).

Within manufacturing, the share of the transportation equipment industry in MNC-exports was 28 per cent, more than half of this share being attributable to motor vehicles and parts. The same industry's share in MNC-imports of manufactures was 36 per cent. (Data are unavailable for the corresponding share of motor vehicles and parts.) Within the transportation equipment industry, motor vehicles and parts accounted for 93 per cent of the parent exports to their foreign affiliates. (Data are unavailable for the corresponding imports.)

In 1982, Canada took 17 per cent of total U.S. MNC-exports, (versus 16 per cent of all U.S. exports), down from 23 per cent (versus 21 per cent of all U.S. exports) in 1977; 56 per cent of these Canada-destined MNC-exports were shipped by U.S. parents to their Canadian affiliates in 1982. This was double the share of all foreign affiliates in total host country-destined MNC-exports. The sharp difference can be explained largely in

terms of the parent exports of road vehicles and parts for either resale or further processing or assembly by the Canadian affiliates.

If we limit our attention to majority-owned foreign affiliates (MOFAs) in the definition of MNC-trade, then, of the total U.S. MNC-exports to all the MOFAs in Canada, road vehicles and parts accounted for 58 per cent in 1982. Further, of the total U.S. MNC-exports of road vehicles and parts to all MOFAs in the world, the share of the Canadian MOFAs was 84 per cent.

Data are unavailable for Canada's share of total U.S. MNC-imports. However, in 1982 Canada's share of total imports shipped by all foreign affiliates in the world to the United States was 42 per cent; 79 per cent of these Canada-originating imports were received by the U.S. parents themselves. If we limit our attention to MOFAs in the definition of MNC-trade, Canada's share in total MNC-imports was 44 per cent. Although motor vehicles and parts accounted for 24 per cent of total MNC-imports from all host countries, its share in MNC-imports from Canada was 51 per cent.

It is also useful to compare the sales structure of the Canadian MOFAs with that of all MOFAs in 1982. Of the total MOFA sales, the Canadian MOFAs accounted for 15 per cent in all industries, 20 per cent in manufacturing, and 33 per cent in transportation equipment. Of the Canadian MOFA sales, 56 per cent were in manufacturing, 19 per cent in transportation equipment, and 17 per cent in motor vehicles and equipment. The corresponding shares for all MOFAs in all host countries were 48 per cent, 9 per cent, and 8 per cent, respectively. (The shares were slightly higher for the MOFAs based in other developed countries.) So, the sales by Canadian MOFAs consisted of manufactures to a significantly larger degree than those by MOFAs in other host countries. This could be explained by the far above average relative importance of the Canadian MOFAs that manufacture motor vehicles and equipment for both local sale and export to the United States.

Exports accounted for 23 per cent of the Canadian MOFA sales but 35 per cent of all MOFA sales. However, exports to the United States were 19 per cent and exports to the U.S. parents 16 per cent of the Canadian MOFA sales. The corresponding shares for all MOFAs were 11 per cent and 9 per cent, respectively. So, the Canadian MOFAs had almost twice the relative export dependency on the United States of all MOFAs.

Manufacturing accounted for 75 per cent of the Canadian MOFA but only 34 per cent of all MOFA exports to the United States. The corresponding shares for the transportation equipment industry were 55 per cent and 16 per cent, respectively. Again, the large automotive exports by the Canadian MOFAs to their parents provide the primary reason for these sharp differences.

Thus, we conclude that U.S. MNC-trade with Canada is indeed substantial. It dominates the bilateral trade in manufactures. Especially significant is the U.S. intra-MNC-trade in motor vehicles and parts, which has been covered by auto pact since 1965. This U.S. data-based conclusion is in parallel with the Canadian data-based findings of Statistics Canada on the importance of intra-corporate imports from the United States (Government of Canada, 1983, pp. 31-32) and with the statement that "some 70 per cent of

U.S.-Canadian merchandise trade is currently intra-firm" (Rugman, 1986a, p. 7). It also supports Morici (1984, pp. 83-84) that "in probably no other AIC (advanced industrial country) are efforts to achieve industrial adjustment as potentially influenced by corporate strategy decisions of MNCs based in a single foreign country, nor are its prospects for long-term competitiveness so dependent on the future of foreign enterprises based there."

III. Potential Impact of a Bilateral Free(r) Trade Agreement on U.S. Direct Investment in Canadian Manufacturing: Theory and Empirical Evidence

According to *The Economist* (1986, p. 15), "if a free trade pact—including a truce on non-tariff barriers—is agreed, its biggest impact may be on investment, not trade." Even if this statement is true, it is of limited significance because of the difficulty in predicting what that impact will be. Nevertheless, several attempts at predictions, mostly by Canadian authors, have been made, based partly on economic theory and partly on empirical evidence. These attempts are mostly speculations, revealing both the weaknesses in our theoretical knowledge and the gaps in our empirical information.

> Opponents of FTA either claim that Canada will suffer a massive exodus of long-term capital or that Canada will be inundated with so much long-term capital that it will cease to exist as a separate sovereign state. The range of opinion about the relationship between FTA and long-term capital flows is a telling statement of our apparent ignorance about the fundamental forces at work (Burgess, 1986, p. 24).

This section reviews the various attempts to understand that relationship and tries to sort out the more plausible ones.

One basic problem in predicting the impact of FTA on DFI is that the impact depends on the yet uncertain content of the FTA itself (Safarian, 1985, p. 206; Burgess, 1986, pp. 3-8). Both Canada and the United States have announced that they want the FTA to be a comprehensive one, as opposed to one covering only selected sectors in the spirit of APTA. The sectoral approach was considered first—in terms of steel, urban mass transit, petrochemicals, textiles and clothing—under the Liberal government of Prime Minister Trudeau, but abandoned later by the present Progressive Conservative government. U.S. governments have tended to favour the comprehensive approach, letting, however, Canada make the choice (Hufbauer and Samet, 1983 and 1985; Meany, 1985).

Each country, especially Canada, is likely to insist on several, either temporary or permanent, exceptions and safeguards, that is, provisions that directly or indirectly restrict the free flow of goods and services. NTBs, on both the federal and sub-federal levels, will be much more difficult to reduce than tariffs, which are already relatively low. One thing we do know for certain is that whatever agreement is reached, it will be implemented gradually in order to ease the adjustment burdens. It might have a 10-year

transition period like the U.S.-Israeli Free Trade Area Agreement signed in 1985 (U.S. Trade Representative, 1986, pp. 97-98). Therefore, its impact on DFI should also be gradual.

Another basic problem is that in the real world of many industries with many firms, the potential impact of any FTA would be very difficult, if not impossible to generalize, even if we knew precisely all the firm-specific or the industry-specific effects. (Of course, we are extremely unlikely to possess such precise and complete knowledge.) It would also be tempting but misleading to expect the impressive results achieved in the automotive industry under APTA during the last two decades to obtain for the rest of manufacturing under a comprehensive FTA. (The same is true of the older Defence Production-Sharing Arrangement which has provided virtually unrestricted trade in military hardware between the two countries.)

In discussing FTA's potential impact on U.S. DFI in Canadian manufacturing, I will, with some oversimplification, distinguish between two broad and opposing arguments. The **pessimistic** argument concludes that substantial U.S. disinvestment might result, causing deindustrialization in Canada. This argument represents the position of the Canadian Labour Congress in its purest form. The **optimistic** one, on the other hand, concludes that not only DFI might increase but also its structure might change to the benefit of both countries. This argument represents the position of many academic economists, the (Canadian) Business Council on National Issues, and the Canadian Manufacturers' Association, who might differ among themselves about its specific aspects.

These two essentially economic arguments are both based partly on theoretical reasons and partly on empirical evidence. (I will not deal here with another "pessimistic," the **nationalist** argument that expects FTA to **increase** U.S. DFI by so much that, Canada would end up as an economic and political colony of the United States. It transcends economics and my limited understanding of the extra issues raised.)

On the theoretical side, the **pessimistic** argument assumes trade and DFI in manufacturing to be substitutes. (This could be the result of adopting the framework of the logically elegant but empirically weak standard Heckscher-Ohlin trade theory, whose own assumptions are incompatible with the existence of MNCs.) This argument attributes the chief cause of DFI in manufacturing to host-country protectionism and import-substitution policies.

According to this argument, the foreign-owned subsidiaries in the host country are established as inefficient and internationally uncompetitive small-scale branch plants, "miniature replicas," to serve the local market. They remain inefficient and uncompetitive long after they come into existence because the host country's protectionism continues indefinitely. These infants never grow up. (This is another negative aspect of the **pessimistic** argument, which raises the question about the economic sense of begetting those infants in the first place.)

If protectionism *vis-à-vis* the source country were to end, the parent firms would no longer wish to maintain their host country operations. Competition from their own

national rivals in supplying the host country, as well as their desire to maximize profits by minimizing costs, would eventually force them to export from their efficient home operations. The "branch plants" would be closed sooner or later, throwing people out of work, as the host country gave up its efforts to diversify its economic base by industrialization under protection.

I have come across two papers that put forward the **pessimistic** argument. Chisholm (1985) distinguishes between vertical and horizontal integration within an MNC, in terms of the interdependence between the parent firm and its foreign subsidiaries. Vertical integration prevails in the host country's natural resource sector. DFI in this sector is not motivated by protectionism and therefore is not to be adversely affected by FTA. Horizontal integration is predominant in manufacturing due to the host country's protectionism.

The horizontally integrated branch-plant subsidiaries would definitely suffer under FTA. They would be phased out unless their role within the MNCs could be redefined via either rationalization or world product mandates (WPMs). Rationalization transforms horizontal integration to vertical integration by expanding a subsidiary's scale of operations and specializing (narrowing) its product line. After rationalization, the subsidiary becomes internationally competitive and export-oriented.

WPM is the subsidiary's "total responsibility for particular products or operations within the multinational . . . (including) responsibility for all aspects of research and development . . . for manufacturing and . . . for inter-national marketing" (Chisholm, 1985, p. 19). The evolution of the WPM concept in Canada and a critical appraisal of its implementation can be found in Rugman and Bennett (1982) and Rugman (1985).

What are the chances for either rationalization or WPMs, according to Chisholm? Minuscule because U.S. MNCs themselves are facing tough competition from MNCs based in the newly industrializing countries (NICs). Therefore, they would not wish to restructure their Canadian branch plant subsidiaries in the case of an FTA. Even if they were to wish it, the limited capabilities of Canadian management would be an obstacle. (The low opinion about the capabilities of Canadian managers and workers is another aspect of the **pessimistic** argument.)

The major weakness of Chisholm's analysis is its sweeping generalizations without empirical evidence. No distinction is made among different manufacturing industries, on the one hand, and among MNCs of different sizes, on the other. The complexities of the DFI process and the multi-dimensional global strategies of the larger MNCs—emphasized by the **optimistic** argument—are ignored completely. It is a somewhat refined but unpersuasive version of the pessimistic argument.

Baranson (1985), in his report for the Ontario Ministry of Industry, Trade and Technology, couches the **pessimistic** argument in the high-tech idiom of flexible manufacturing systems (FMS) and computer-integrated manufacturing (CIM). He argues that U.S. MNCs are increasing their U.S.-based international competitiveness. By restructuring and modernizing their U.S. production facilities into rationalized and automated "CIM clusters," they are ushering in a new era of industrialization.

Subsequent to an FTA, especially one that dismantles many NTBs, U.S. MNCs would liquidate most of their Canadian branch plants ("structured pygmies") for two reasons. First, those plants are, on average, 30 per cent less efficient than U.S. plants, despite their adjustment to declining Canadian protectionism during the last three decades. Second, U.S. MNCs prefer to locate their CIM clusters in the revitalized Rustbelt (midwest) and Sunbelt (southeast to southwest) regions of the United States where labour is cheaper and technologically more adaptable than in Canada (Baranson, 1985, p. 3).

Some branch plants, according to Baranson, could survive FTA after extensive rationalization and strengthened WPMs, especially if they received public subsidies, but "most Canadian satellite production facilities, along with any related RD&E facilities, would dwindle and disappear" (pp. 6-7). The branch plants in metalworking, machine building, electric and electronic products would be particularly hard hit, since these industries are in the forefront of CIM in the United States (p. 9).

Much of Baranson's analysis is technologically sophisticated but exaggerated and lacking in empirical evidence. Like Chisholm, he has a rather simplistic view of strategic decision making by MNCs. Likewise, he underrates the capabilities of Canadian labour and management who operate the branch plants, in adjusting to change in either trade policies or production technologies. His argument is based primarily on the importance of FMS/CIM. Even if FMS/CIM were that important for all manufacturing—which is doubtful—its asserted decisive effect on the location of production (favouring the United States at the expense of Canada) is unfounded.

Moreover, as my survey of 28 U.S. MNCs suggests, the future of many Canadian branch plants might be threatened more **without** an FTA than with it. In other words, the strategic interests of many U.S. MNCs in rationalizing and maintaining their Canadian operations could depend on whether those operations can be justified in terms of North American integration. The *status quo* may not be sustainable indefinitely. As emphasized by Morici (1984), the common global competitive challenges facing the United States and Canada could be most effectively met on a North American basis.

These are then the two versions of the **pessimistic** argument asserting an unfavorable impact of FTA on DFI. They are not based on either formal modelling or direct empirical evidence. Brown and Stern (1986), although clearly not proponents of that argument, also come up with an unfavourable result, but on the basis of their computational general equilibrium model. Their study is reviewed later in this section.

On the theoretical side, the **optimistic** argument is more developed and persuasive than the pessimistic one. It views trade and DFI more as complements than as substitutes. This results from its more complete understanding of the complex DFI process. MNCs exist and DFI occurs for many other reasons besides trade barriers of the host countries.

General equilibrium analysis of Markusen (1984) shows that even when trade is completely free, an internalized technical efficiency advantage arising from firm-specific economies of multi-plant operation (created by a joint input, such as an innovation, whose

plant-specific productivity is independent of the number of plants under single ownership) by itself can give rise to MNCs and DFI. Then DFI and trade will be complements.

This complementarity, again under free trade, holds also in the general equilibrium model of Helpman and Krugman (1985, pp. 227-258), especially with vertical integration. Their model assumes—besides the existence of some specialized inputs, such as product-specific research and development (R&D)—product differentiation and economies of scale in manufacturing. MNCs generate both intra-industry and intra-firm trade in addition to inter-industry trade.

According to the modern (that is, post-Heckscher-Ohlin) theories of trade and DFI, such as Dunning's eclectic Ownership–Location–Internalization (OLI) paradigm, even without protectionism, we would expect MNCs to survive and DFI to continue (Dunning and Norman, 1985). In fact, as individual firms have recently faced higher economic and political risks—not all of which could be externally hedged or diversified—they have chosen to internalize some of those risks by transnational (but internal) diversification. In other words, they have been able to move closer to "optimization under uncertainty" (McCulloch, 1985, pp. 144-148) or have been able to "exploit uncertainty through operational flexibility" by becoming multinational (Kogut, 1985).

One of the significantly higher risks during the last 15 years has been the volatility of real as well as nominal foreign exchange rates. Depending on their international market structures, uninational firms could reduce their operating (profit margin) exposure, a function of real exchange rate volatility, by turning into multinationals (Lessard and Lightstone, 1986). No financial market instruments are available for transferring the risk created by the volatility of real exchange rates.

Getting back to the **optimistic** argument, it does not deny that some foreign subsidiaries, operating behind trade barriers, may be inefficient and uncompetitive. However, it believes that the parent firms, for several reasons, would wish initially to rationalize, not close them, subsequent to FTA. The subsidiaries would become more export oriented and closely integrated with their parents, as they gained efficiency and competitiveness. Even if some old plants were to be shut down by their parents, new ones would be built by either the same parents or others in the same or different industries. FTA would increase not only the amounts of DFI and especially intra-MNC trade, but also the efficiency with which they occur. Consequently both the source and the host country would derive greater benefits from them than before.

Interestingly, if all or most branch plants were inefficient under protection and could not be rationalized, then their closure, by increasing allocative efficiency, would be, under certain conditions, to Canada's **benefit.** This is the implication of the "immiserizing foreign investment" literature which shows that a country that attracts foreign (either direct or portfolio) investment by tariff protection can suffer a welfare loss. In a way, the host country allows itself to be "exploited" by foreign capital by paying it a return above its marginal product, valued at world prices. (Brecher and Diaz Alejandro,

1977, and Brecher and Findlay, 1983, state the theoretical argument, which is generally supported by the case study of Erdilek, 1982.)

Several authors have presented different versions of the **optimistic** argument. A short and implicit version, developed before the emergence of the FTA issue and based on econometric analysis is that of Globerman (1979, pp. 23-28 and pp. 48-50).

> "... While the Canadian tariff is an important factor influencing foreign direct investment in Canada ... it is not the only factor—or, necessarily the most important factor—in specific ... industries.
>
> "Thus elimination of the domestic tariff by itself would not necessarily encourage a substantial substitution of exporting activity for direct investment activity in various Canadian industries" (p. 23).

(One set of Globerman's regression results actually shows the Canadian tariff as the statistically most significant variable in explaining U.S.-owned subsidiary sales in Canada as proportion of the sum of those sales and U.S. exports to Canada. The regression explains, however, less than 25 per cent of the total variation in that proportion.)

Daly and MacCharles (1986), although not directly concerned with FTA's impact on DFI, present strong empirical evidence, which they analyze persuasively, in support of the **optimistic** argument. Much of their work is based on an in-depth 1982 study of a matched sample of 15 U.S.-owned subsidiaries and 15 Canadian-owned companies in several secondary manufacturing sectors.

They find no evidence that during the previous periods of trade liberalization "... the subsidiaries were going to be closed down" (p. xix) or "... subsidiaries are closed in Canada when they have problems, or when employment in U.S. (parents) is threatened" (p.77).

In fact, they demonstrate that the U.S. subsidiaries would be on the whole better positioned, relative to Canadian-owned firms, in adjusting to and benefiting from further trade liberalization. They blame Canadian protectionism and managerial shortcomings, which they hold responsible for low productivity and high costs, for most problems of Canadian manufacturing, especially its poor export performance.

> While access to U.S. markets through a free trade arrangement is necessary for improved competitiveness, it will not be sufficient. Cost reductions must also be achieved, through a combination of productivity improvement and restraint on price and wage increases (p. 60).

Daly and MacCharles (1986) emphasize throughout their analysis the necessity to increase the scale of production and to decrease the diversity of product-mix, that is, to specialize more, in order to reduce unit production costs in Canadian manufacturing. (Those costs could be reduced by 20 to 30 per cent if output levels were to triple.) They argue that, given the small domestic market, this can be done only by exporting more, especially to the United States.

Safarian (1985) marshals both theoretical and empirical evidence against the pessimistic argument as he builds a strong case for the optimistic one. Invoking the

modern theory of MNCs, in the version developed by Caves (1982), he emphasizes the complementarity between trade and DFI. But he also shows that the determinants of DFI go far beyond trade policies. His empirical analysis, based on suggestive and mostly macroeconomic evidence, notes the difficulty of making predictions about FTA's impact "except at the firm and industry level" (p.210). Despite that and other words of caution, the cumulative force of Safarian's comprehensive argument supports optimism.

Burgess (1986) distinguishes between the static (short-run) and dynamic (long-run) effects of FTA on DFI within a descriptive general equilibrium framework. The static effect might be a shift of DFI from manufacturing into primary and services sectors (p. 14). But the dynamic effect is likely to be DFI-enhancing (pp. 14-24). Burgess states and refutes the pessimistic argument, which he regards as "either groundless or exaggerated" (p. 16).

He emphasizes the importance of unexploited scale economies in the branch plants that can be realized through longer production runs for export, after the source-country trade barriers are lifted. Like Safarian, he notes that trade restrictions are only one of the several determinants of DFI. Transport costs, differences in relative costs of production, local tastes with respect to product design and servicing requirements between the source and host countries all play an important role.

Rationalization of their branch plants and specialization of their product lines would be the most likely response of U.S. MNCs to FTA. "A decision to shift a product line within an MNC should not be confused with a decision to divest. Under FTA there is a strong presumption that new DFI will occur in sunrise product lines to replace any exodus of DFI in sunset product lines" (Burgess, 1986, p. 18). Clearly, some branch plants might be closed down, but that would improve the efficiency of resource allocation and thus benefit both the host and source countries. Given the facts that intra-MNC trade is already substantial between the two countries, and that DFI and trade have in the past increased together, then FTA, by liberalizing and expanding trade, would also stimulate DFI.

Burgess (1986) shows that any massive exodus of U.S. DFI from Canada, due to FTA, is implausible in terms of its general equilibrium implications (pp. 20-21). He also refutes the argument that if FTA benefits Canadian workers by raising their real wages, U.S. MNCs would no longer find Canada a more attractive production location than the United States (pp. 22-23). Despite the strength of his theoretical analysis favouring the optimistic argument, Burgess concludes that ultimately the (FTA impact on DFI) issue can be resolved in only empirical terms (p. 31). Moreover, he warns against identifying the ultimate objective of FTA with the promotion of DFI in Canada (p. 21 and p. 31). FTA is aimed at increasing economic efficiency and thereby real incomes, not attracting DFI as an end in itself.

The Report of the Royal Commission on the Economic Union and Development Prospects for Canada (1985, Vol. I, ch. 6), after developing the case for FTA with the United States, takes up the DFI impact issue as one of the "problem areas" (pp. 331-334). Its analysis reflects to a large extent that of Burgess, whose earlier work on the subject was done for the commission. The commission's report also examines the likely effects of

FTA on Canadian industry sector by sector (Vol. I, pp. 336-349). In this sectoral examination emphasizing the diversity of Canadian manufacturing, the DFI issue is only one of the several considered. The report (p. 348), which accepts the likelihood of disinvestment in some sectors such as tires and medical equipment, concludes as follows:

> Would multinationals leave Canada in reaction to free trade? One argument is that multinationals originally located here to circumvent our tariffs and would therefore leave if those tariffs were reduced. Some multinationals have already left Canada in reaction to Tokyo Round tariff cuts, but there has been no exodus. For several reasons, such a move would be an unlikely consequence of Canada-U.S. free trade. It is not easy to move capital investment. If there are productive opportunities to invest here, foreign investment will pursue them regardless of trade restrictions. If free trade increased access to the U.S. market and made it more secure, opportunities for productive investment in Canada would increase rather than decrease.

Rugman, in his various writings on MNCs, has extolled them as highly desirable instruments of economic efficiency and global integration. Not surprisingly, his version of the optimistic argument, taking off from Safarian (1985) and Burgess (1986), is the most enthusiastic one. Rugman (1986b, pp. 9-10) invokes his internalization theory, which explains DFI as an efficient response of MNCs to exogenous transaction costs, to reject the pessimistic argument's preoccupation with protectionism as the determinant of DFI.

In Rugman and Tilley (1986a), Rugman emphasizes the growing importance of intra-industry of DFI (IDFI), which is defined by Erdilek (1985, p. 1) "as the two-way DFI by multinational enterprises, based in different countries, in each other's home markets, to produce goods and services that are close substitutes in either consumption or production, and thus can be classified in the same industry." IDFI, like intra-industry trade and intra-firm trade to which it is closely related, is both a cause and an effect of the globalization of industries. (Rosegger, 1986, analyzes this phenomenon in the automobile industry.) IDFI between Canada and the United States would be increased substantially by FTA.

Rugman believes that FTA is essential to strengthening North American continentalism, the economic integration already achieved by MNCs. "Not only are trade and investments complementary; a free-trade area is one way for governments to compliment [*sic*] the strategic planners of multinational enterprises" (Rugman, 1986b, p. 14).

According to Rugman, the transnational and homogeneous outlook of the U.S. and Canadian MNCs, which is in the consumer interest, can be counted on to minimize the adjustment costs of FTA. Since the intra-firm trade of those MNCs accounts for the bulk of U.S.-Canadian merchandise trade, much of the burden of adjustment would fall on them. They would adjust gradually by rationalizing their operations across the two countries with minimum private and social cost (Rugman, 1986a, pp. 7-8; Rugman and Tilley, 1986b, p. 24). U.S.-owned subsidaries, many of which "are more than branch plants attracted by the tariff . . . employ good managers . . . and enthusiastic workers" would prosper, especially by gaining WPMs (Rugman, 1986b, pp. 11-12). (Rugman has

changed his earlier critical position toward WPMs in light of the FTA possibility.) This is by far the most cheerful version of the **optimistic** argument, whose sweeping generalizations are not adequately substantiated.

Rugman, too, cites only macroeconomic evidence, such as the observed parallel increases in trade and DFI within the European Economic Community (EEC) after its formation, in support of the optimistic argument. He does, however, suggest that in order to predict the impact of FTA on DFI, we should ask the strategic planners of major multinationals about their likely responses.

Wolf (1986) is concerned about the problems in finding and using empirical evidence to predict the responses of MNCs to FTA. He mentions four possible sources of such evidence (p. 9): (1) surveying the managements of both the parents and their subsidiaries about their intentions, (2) observed responses of U.S. MNCs to earlier trade liberalization, (3) observed responses of U.S. and non-U.S. MNCs to trade liberalization elsewhere, for example, the EEC, (4) econometric modelling.

Under (1), MNC managements could be asked to reveal their plans in terms of (i) maintaining the status quo, (ii) rationalizing the branch plants, (iii) promoting WPMs, (iv) closing down the branch plants. (These are in fact the alternatives that I explored in my survey of 28 U.S. parent firms, as 10-13). Wolf discounts too heavily, however, the reliability of such information relative to either indirect or secondary alternative sources of empirical evidence. He seems to fault MNC managements for either not having perfect knowledge about the future or not sharing that knowledge with an outsider.

According to Wolf (1986, p. 13), one survey of Canadian subsidiaries (but not U.S. parents), conducted by F. Lazar about the potential employment effect of FTA in Ontario, did not yield very useful results. Most of them evidently did not have any explicit plans. The review of Lazar's conclusions by Proulx (1986, p. 54), however, reveals that they were offered in support of the **pessimistic** argument, in particular, the version of Baranson (1985).

Wolf (1986) also reviews several studies that investigated the observed responses of U.S. MNCs in Canada to earlier trade liberalization under the GATT Rounds (pp. 14-16). These support the **optimistic** argument in terms of significant rationalization achieved in Canadian subsidiaries. The evidence from the responses of MNCs to trade liberalization elsewhere likewise favours the **optimistic** argument (pp. 18-20).

Brown and Stern (1986), not only present their own model and simulation results, but also provide an extensive survey of the econometric evidence from several other multi-sectoral trade models. It should be noted that most of these models are aimed at estimating the various economy-wide effects of FTA in Canada. The DFI impact is not their only, or even major concern.

In fact, since many of them do not incorporate DFI explicitly, they have nothing to say on the issue, as has been noted by Proulx (1986, p. 55) in his comprehensive survey. The results obtained from most of these models, especially those such as Harris (1984) that incorporate intra-firm scale economies at the plant level, allowing for rationalization

and pro-competitive effects, appear to favour trade liberalization from Canada's (total welfare) view point.

The FTA simulation results presented by Brown and Stern (1986), whose model excludes scale economies, are not, however, favourable for Canada. It would take me too far from my limited task here to discuss their results in full and why theirs differ from the results of other models. (Besides, Brown and Stern themselves offer an excellent discussion.) What is directly relevant for our purposes is their **pessimistic** estimate of what they unjustifiably refer to as the "DFI" impact: under FTA, Canada loses capital to the United States.

Like any computational general equilibrium model, their model makes certain simplifying assumptions. But under their assumptions, such as perfect competition and international capital mobility based on differences in the rate of return (capital's marginal value product), we cannot distinguish between portfolio foreign investment and DFI or between gross foreign investment and net foreign investment in any given sector. It does not suffice that capital is sector-specific in their model. Many other neo-classical general equilibrium models have been argued to share this weakness (Erdilek, 1976; Markusen, 1984).

In this static (short-run) Armington-type (product heterogeneity by country) model of Brown and Stern (1986) with constant returns to scale and fixed capital stocks, the international but intra-sectoral capital flows are one-time net (versus gross) investments. In other words, it is a one-shot reallocation of given sectoral capital stocks which are not initially distinguished by the nationality of their owners. Since the scale effect is ignored, the branch-plant rationalization issue does not exist. (Brown and Stern, 1986, pp. 12-18, in their survey of the other trade models, do, however, discuss the scale effect, noting that it is not a sufficient condition for gains from free trade.)

Therefore, despite the rigorous econometric modelling approach of Brown and Stern (1986), I am highly sceptical about the empirical relevance of their result about the DFI impact of FTA. It is an unintended and potentially misleading contribution to the **pessimistic** argument.

Ensch (1985) offers sectoral and company-specific empirical e idence for the **optimistic** argument in the Canadian tire industry, dominated by the subsidiaries of U.S. and French MNCs. In 1984, 28 per cent of Canadian production of car and truck replacement tires (not covered by the auto pact and subject to 4 per cent U.S. tariff) was exported to either U.S. parent companies or customers of the parents. Without these exports, the Canadian replacement-tire industry could not have achieved any significant scale economies. Its average plant size (10,000–20,000 tires per day) was, however, still much smaller than that found in the United States (20,000–50,000 tires per day.) The replacement aftermarket in Canada was between 11 million and 12 million tires versus 180 million tires in the United States.

The Canadian industry, already confronting serious third-country competition in both Canada and the United States, could find itself in much more difficulty if U.S.-made replacement tires were to enter Canada duty free. Ensch, writing as the general

manager, tires, of B.F. Goodrich, Canada, Inc., argues that—even without much direct help from the Canadian government—the industry had been rationalizing (lowering costs through product and process improvement) in the face of third-country competition.

Against a possible flood of imports from the United States despite the "73 cent dollar," the industry would have to "rationalize even more, increasing dependence of the U.S. market;" alternatively, "modify to specialty, high-tech and niche-type products where second and third world industry can not compete" (Ensch, 1985, p. 50). He notes that B.F. Goodrich, Canada had emphasized the "niche picking strategy," as a result of which more than 50 per cent of its tire lines were only three years old or younger.

This review of the theoretical and empirical evidence strongly suggests but, of course, cannot conclusively prove, that the impact of an FTA on U.S. DFI in Canadian manufacturing would be favourable. (We assume that this FTA will eliminate gradually all bilateral tariffs and lower most bilateral NTBs in manufacturing.) First, the efficiency of most subsidiaries would improve through either rationalization or WPMs. Many would also become better integrated and more interdependent with their U.S. parents. Second, the greater efficiency would induce the parents to expand their scale of Canadian operations. (FTA would also attract more DFI to Canada from outside the United States.) Consequently, both intra-firm and inter-firm trade would increase between the two countries.

We know that this has been the outcome in the Canadian automotive industry subsequent to APTA. (The auto pact provides for bilateral free trade in all original equipment parts and vehicles, but not in replacement parts, replacements tires and used cars.) We also know that Canadian safeguards, that is, local content and one-for-one production-sales ratio requirements, built into the auto pact might have played an important role in that outcome. (It should be emphasized that automotive bilateral trade under the pact has been largely free from direct restrictions, that is, tariffs, but not from indirect Canadian restrictions, that is, inward DFI-related performance requirements.)

It is also highly unlikely that the United States would accept in FTA similar safeguards favouring the rest of Canadian manufacturing. (The United States might actually insist on the elimination of those in the auto pact, which were supposed to be transitory, although a time limit was not specified. Canada, however, despite its recent desire to increase Canadian components production relative to assembly activity, has been reluctant to renegotiate the pact with or without FTA. It is concerned that attempted revisions might cause the unravelling of the auto pact. The current controversies in the United States surrounding the Canadian duty remission program for third country-based producers as well as their exclusion from the auto pact, may soon, however, require some significant adjustments.)

Therefore, for that and several other special circumstances, such as the highly concentrated market structure of the North American automotive industry dominated by three U.S. MNCs, we should not rely heavily on the APTA precedent for predicting the impact of FTA.

In the next section, I summarize the results of my recent informal survey of 28, mostly large but also a few small U.S. MNCs on their likely responses to FTA. Like this section's survey of the theoretical and empirical evidence, those results lend support to the optimistic argument.

IV. Results of an Informal Survey of U.S. Multinationals on Their Likely Responses to a Bilateral Free(r) Trade Agreement

After I was asked to prepare this paper, I decided to survey at least a few U.S. MNCs in order to add some realism if not scientific rigour to my discussion. (Conducting a formal survey by a questionnaire to collect standardized data for statistical testing, as in Erdilek,1982, was not feasible because of the shortage of time and the substantial costs involved.)

I obtained from a Washington-based public interest and research group its list of people who were active in promoting Canadian-U.S. relations. The list contained, among others, the high-level executives of 27 mostly large and well-known U.S. MNCs in manufacturing. In addition to that list, I received from the Canadian Consulate General in Cleveland, a list of 32 U.S. manufacturing firms (and the names of their chief executives)—based in the four states within the consulate's responsibility—with Canadian subsidiaries.

First, I wrote to the executives of all of these 59 firms asking for their written or oral answers to the four questions listed below. Of course, I had to promise them confidentiality. As expected, I received only a few cooperative responses to my letter initially. Then I began to telephone those who had not responded either favourably or unfavourably.

Twenty-eight of those to whom I had written agreed eventually to either only talk with me by telephone or also send me their written replies. (The cooperative response rate was much higher among the larger firms.) Almost all of those who cooperated were well-informed and forthcoming. They all have my sincere thanks for their valuable help. (The big three U.S. auto manufactures were not among the firms that I contacted. I did, however, communicate with the chief economist of one of them, as well as with an official of the U.S. Motor Vehicle Manufacturers Association, about the present status and the likely future status of APTA under FTA.)

Here are the four questions I asked the U.S. MNCs:

1. How would an FTA affect the flow of goods and services between your parent firm and your Canadian affiliate(s)?

2. How would you change the scale and structure of the operations of your Canadian affiliate(s) as a result of an FTA?

3. Which types of Canadian and U.S. (federal and provincial/state) government policies in addition to an FTA would lead you to change the scale and structure of the operations of your Canadian affiliates(s)?

4. How would you wish Canadian (federal and provincial) government policies toward U.S. investors to change in the presence of an FTA?

The answers received from the 28 respondents are summarized below. (None of the Canadian affiliates at issue was minority-owned; most were wholly-owned subsidiaries.) I should note that this summary reflects only qualitatively the subjective views of a sample of U.S. MNC executives, mostly presidents or vice-presidents for international operations. Some executives stated either that their views might not be shared by their colleagues in the parent firm or that the views of the parent firm and the Canadian subsidiary could be different on certain issues.

This potential divergence of opinion was particularly serious in large parents that had multiple divisions with separate subsidiaries. I was able to obtain division-specific responses from such parents only in one case. In most cases, however, respondents did try to distinguish among their different product groups, even when the parent had only a single Canadian subsidiary.

The sample was not chosen according to any statistical criteria, given my time and financial constraints. It was intended to be more suggestive than representative. (However, since it was more or less a random sample, it included firms from a large variety of industries such as capital goods, metal products, construction materials, paper, chemicals, glass, paints, plastics, tires, consumer durables, and consumer non-durables.) Therefore, those who disagree with my findings might dismiss them as "unscientific." I hope that they would be able to do better, especially if I myself cannot in a later study.

1. *Effect of FTA on Flow of Goods and Services*

Most respondents indicated that since on their products the Canadian tariffs were generally higher than the U.S. tariffs—and the Canadian prices were above the U.S. prices—FTA would stimulate bilateral (both intra-firm and inter-firm) exports from the parent more than those from the subsidiary. This response was qualified by the importance of shipping costs, product differentiation (in terms of nation-specific designs, labelling, and government regulations), local servicing required by the markets, government procurement policies favouring domestic products, various government subsidies for local production and exports, and last but not least the bilateral flexible exchange rate. Some also remarked that their relative unit costs and, therefore, trade patterns might be affected by the indirect impact of FTA on the relative prices of the inputs they sourced in Canada and the United States. There were, however, a few exceptions to the consensus. One of them was the World Product Mandate (WPM) already assigned to a Canadian subsidiary in the manufacturing of customized airline (counter) terminals for export to both the United States and the rest of the world. The parent did

not produce them in the United States. The elimination of the 5 per cent U.S. tariff on these products could boost their exports to the United States.

Another exception was engineering fasteners (nuts and bolts) whose exports to the United States could rise significantly after the elimination of the 8.5 per cent U.S. duty. The Canadian plant already exported 30 per cent of its output to the United States. Two of the parent's U.S. plants making these fasteners had been shut down recently because of their higher cost and poorer quality.

On the whole, parent versus subsidiary exports of intermediate products would be stimulated more than those of finished goods. (According to Daly and MacCharles (1986, pp. 38-41), the subsidiaries already imported substantially more intermediate products for further processing than finished goods for resale.) Several respondents explained that especially in finished consumer goods, each of their two markets was supplied almost entirely by their local plants, without significant bilateral exports. This would not change much in the short run, especially if FTA were to be phased in gradually. Perhaps the product lines in some consumer durables, for example, some major appliances, sold in Canada could be extended by parent exports. It was also made clear by the others that the initial and overall more favourable impact of FTA on parent exports would become less marked over time as the subsidiaries were restructured, rationalized, and possibly expanded.

Although many respondents did not try to predict how the present exchange rate would change after FTA, almost all of them mentioned explicitly its critical role in any commercial or investment decision of their firms. One respondent noted that the exchange rate mattered greatly as the parent evaluated the subsidiary's profitability on a translated U.S. dollar basis, with the subsidiary's operational results translated at current exchange rates but its investment base expressed in historical U.S. dollars. "So, the Canadian subsidiary's results now look terrible," he concluded. (Daly and MacCharles (1986, pp. 82-83 and pp. 108-109) discuss the economic implications of the various accounting methods of foreign exchange translation for the U.S. subsidiaries in Canada.)

As for the function of the exchange rate under FTA, another respondent wrote: "To the extent that a trade agreement might significantly alter the trade balance between the two countries from existing levels, the imbalance could and probably would be remedied by adjustments in the exchange rate."

The consensus was that the existing lower relative value of the Canadian dollar reflected largely the differences in economic fundamentals such as the lower level of Canadian productivity. According to Morici (1984, p. 80), Canadian labour productivity in manufacturing was about 70 per cent of that in the United States and that the gap was primarily due to "less specialization and shorter production runs." Daly and MacCharles (1986, pp. 11-19 and pp. 116-117) emphasize the 15 per cent higher Canadian unit labour costs, as well as the 28 per cent lower labour productivity, based on 1984 Canadian and U.S. data. They attribute these differences "primarily to the small size and diversity of Canadian manufactures and the quality of management" (p. 18). In his recent testimony to the finance committee of the U.S. Senate, U.S. Trade Representative Clayton Yeutter

stated that "there is no Canadian Government manipulation...of the exchange rate...the very weak Canadian dollar...is due almost entirely to lack of an adequate level of economic performance" (U.S. Senate, 1986, p. 53).

Only a few respondents either claimed the Canadian dollar to be undervalued or argued for a pegged/managed bilateral exchange rate as part of FTA. They were manufacturers of either natural resource-based or iron- and steel-based/related products, who also complained about alleged government subsidies that favored their Canadian competitors in the U.S. markets.

They were also the only ones who voiced either reservations about or opposition to FTA itself. Their lack of enthusiasm for FTA did not stem from any serious weaknesses of their Canadian operations. On the contrary, it reflected their concerns about the increased competitive pressures that might be exerted by their Canadian-based rivals on their U.S. operations.

The responses also varied among firms in different industries. Several firms that produced components for the original equipment manufacturers (OEMs) in the automotive industry noted that under APTA they already traded freely with Canada. The location of their production depended on that of OEMs, and their North American operations had been rationalized and integrated earlier.

Therefore, FTA would have no direct and immediate effect on the production and trade of their OE components as long as APTA was not revised significantly. (None of these firms either wished or expected any drastic revisions in APTA, although a few did complain about Canada's efforts to attract DFI from third countries that allegedly violated APTA.)

Some of these OE manufacturers drew a sharp distinction between their business in OE components, covered by APTA, and business in the replacement market, not covered by APTA. One tire producer noted that it had two plants in Canada. The first plant, modern with optimum scale, which owed its origins to APTA, supplied the OEMs. The second plant, old with sub-optimum scale (half the size of the parent plant), produced—only for local sale—replacement tires that could not qualify as OE. FTA could initially stimulate parent exports of replacement tires, but eventually the Canadian plant would be rationalized and expanded in order to make it competitive in North American market.

2. *Changes in Scale and Structure of Canadian Operations as a Result of FTA*

The consensus revealed, as expected, the current sub-optimal scale and structure of most branch plants that were not covered by APTA. They were not only too small and old but also manufactured too many product varieties for the limited local market with too short production runs. They had in general higher unit costs and lower quality relative to their

parents. Their inefficiency made them globally uncompetitive and also would make them initially uncompetitive in an integrated free North American market. This consensus confirms the results for Canadian manufacturing of Daly and MacCharles (1986, ch. 3), who argue that "failing some natural cost advantage or continuing price protection, increased scale and specialization is the most promising route to cost competitiveness" (p. 52), with the United States.

Some U.S. MNCs, either faced with tougher international competition or saddled with excess capacity, had already begun to trim their Canadian operations as they rationalized their U.S. facilities. In the words of the respondent for a heavy electrical equipment producer: "There had been a tendency to make small lots of many sizes in Canada a number of years ago. Of late, we have tended to discontinue manufacturing in Canada because of low-cost, quality manufacturing in the United States."

This state of affairs was blamed on tariff and non-tariff barriers that had long prevented U.S. MNCs from integrating their North American operations. Most respondents argued that Canada's efforts to promote its manufacturing industry behind trade barriers that had attracted U.S. DFI, were costly for them, but perhaps more so for Canadian consumers. Morici (1984, pp. 79-81) stresses the same factors in analyzing the over-diversification and fragmentation of Canadian manufacturing after World War II.

They strongly approved of Canada's decision to seek an FTA with the United States, noting that Canada had much more to gain from it than the United States. Many pointed to APTA as evidence. FTA provided Canada's only realistic chance to lift its manufacturing industry up to world-class level. Unless Canadian manufacturing became competitive with its U.S. counterpart, it could not enter and survive global competition.

Again, there were exceptions (even outside those covered by APTA). A few respondents indicated that no significant differences in efficiency because of either scale or quality existed between their U.S. and Canadian operations. Their common feature was the necessity to be close to customers because of shipping costs, local tastes, and servicing requirements. They did indicate, however, that FTA would still be beneficial, especially in minimizing their significant distribution costs. It would induce them to restructure their North American operations for greater overall efficiency by, for example, rearranging shipping zones (east-to-west or north-to-south), adjusting product-mixes and siting future plants accordingly, across the border. This was articulated by a major U.S. MNC as follows:

> We see the potential benefits being spread through both countries, but especially in the Pacific Northwest. Today many products, particularly in the non-durable products businesses in which we are primarily involved, are hauled into that area from other parts of both countries at considerable cost. For instance, under the current structure, this Company has been unable to economically justify the construction of any consumer product plants in the western United States north of Kansas City and central California or in Canada west of Ontario.
>
> Placing the cities of Portland, Seattle and Vancouver, etc., in the same market would significantly increase the economic base of that area and thereby encourage us and others to consider building manufacturing

> facilities in it. In turn, this would encourage producers of raw materials for these products to also consider local production. Not only would these actions build the economy of the region, but would also tend to stabilize it by reducing its current dependence on products with cyclical markets that have periods of excess demand followed by periods of high unemployment and depression.
>
> In our case, we not only see advantages from the larger total market resulting from an FTA and thereby opportunities for increased sales. We also see opportunities for increased efficiency. We could improve the rationalization of our manufacturing facilities. The result would be production allocated on a cost and market efficiency basis. Almost undoubtedly, we would find that some products now made on both sides of the border should only be made on one. Specific decisions could be made as the new market developed, but we foresee opportunities, for example, for products that are now made in New England being supplied to the Canadian Maritime Provinces. We can also see possible opportunities to reduce the cost of supplying areas of the Midwest and Northeast from very closely proximate plants in Ontario.

Some respondents, on the other hand, emphasized the relative strength of their Canadian subsidiaries even without having had the benefit of APTA. These would have nothing to fear from FTA. On the contrary, they would thrive as exports to the United States rose. Engineering fasteners were mentioned earlier. Ball bearings, metal stampings and washers produced by another subsidiary should be added to them. Yet another highly modern and automated Canadian operation produced grinding media (steel balls) used in copper ore refining. Its parent might close down the U.S. operation as part of its FTA-induced rationalization. Finally, one subsidiary that manufactured timber-based products in one of the largest and most modern mills in the world, doubled its capacity in 1982.

The interesting common aspect of these exceptions was that they used either Canadian iron and steel or timber inputs. Of course, the exports of both of them to the United States have recently been restricted by the U.S. government. The respondents who revealed these exceptions were also mostly either ambivalent or opposed to FTA, being concerned about potentially tougher competition from their Canadian rivals in the U.S. markets.

Returning to the case of inefficient branch plants, all respondents, not surprisingly, noted that FTA would induce them to either rationalize (with or without WPMs) or phase out their Canadian operations in the face of greater competition. Most of them indicated that the rationalization would encompass all of their North American operations, not just the Canadian ones. As a result of this continental rationalization and integration, their offshore international competitiveness would improve.

The respondent for a heavy electrical equipment producer who was earlier quoted as saying, "of late, we have tended to discontinue manufacturing in Canada . . .", added:

> With FTA, we would rationalize and make products with a significant market in Canada for some sizes, also making products for the United States and Canada, or even the world, and hence probably shoring up Canadian

> production. There would be a tendency to think about North American markets instead of Canadian and U.S. markets.

This response indicates that some U.S. MNCs, recently forced into restructuring (that is, selling off or closing down unprofitable and/or strategically inappropriate operations) by increased domestic and foreign competition, might reduce or even liquidate their Canadian operations **without** FTA. In other words, the **pessimistic** argument might be viewing the *status quo* too optimistically! This might be particularly true in the case of the U.S. tire industry.

One respondent for a U.S. tire-manufacturer parent, which had been going through a major restructuring currently, revealed that rationalization need not involve significant changes in scale:

> An FTA would result in the ability to rationalize North American operations. The scale of Canadian operations would remain approximately the same although a smaller variety of tires would be produced in longer, more efficient production runs. Plant complexity would be reduced. In addition, the absence of U.S.-Canada duties would lower our net cost position, thereby enhancing North American competitiveness versus offshore production.

The second respondent from the same industry, however, indicated that although the parents OE tire plant in Canada was already rationalized as a result of APTA, its replacement-tire plant was not. The latter would have to be modernized, doubled in capacity, and assigned a narrower range of products under FTA.

The third respondent's parent firm in the tire industry had already completed a major "restructuring and transition" in 1985:

> Tire production facilities around the world were coordinated, as part of a significant reorganization, to produce world-class tires for global markets.
>
> The "global" production concept: develop standardized "world" tire lines; enforce strict specification and quality standards; effectively compete in international markets and reap vast economies of scale.

The Canadian subsidiary, with several plants, was made "a world-class producer" as part of this "globalization." Its exports had already registered significant growth following the streamlining. This gave it considerable advantage over all its Canadian-based competitors in adapting to a future FTA. The parent would have to invest in it more, however, in order to maintain its competitive edge. It might also be required to specialize further in its product lines.

Two respondents, although not providing outright support for the **pessimistic** argument, revealed ambivalence and uncertainty about the future of their Canadian operations. The first spoke for a manufacturer of consumer and industrial products in the electrical industry. The parent, with a single plant in Canada, had been recently restructuring its U.S. operations based on the world-scale, mega-plant concept. The aim was to cut costs and improve quality by automation and FMS. That required combining

robotics and computers through computer-aided design (CAD) and computer-aided manufacturing (CAM) systems.

The Canadian plant, supplying primarily the local market, was too small for global competitiveness, despite its lower labour and energy (especially electricity) costs relative to those of the parent. Its unit costs were between 10 and 20 per cent higher than those of the parent. Even with the 8 to 12 per cent Canadian tariff versus the 3 to 5 per cent U.S. tariff, the parent exported to Canada significantly more than the subsidiary exported to the United States.

The parent was undecided about the branch plant's fate under FTA, as the MNC management debated the costs and benefits of remaining in Canada. Much of the uncertainty stemmed from concerns about the overall business environment in Canada, especially the lack of flexibility in adapting to changes in global competition. Both the often adversarial Canadian government policies and the rigid labour union practices reduced the branch plant's degrees of freedom significantly. (These issues concerning the investment climate are discussed below at greater length.)

The branch plant might be closed down if it could not be made competitive in producing low-volume specialty items for the North American market. It would be highly unlikely to receive any WPMs. The MNC offshore exports, for example, to Europe, would be cheaper to source from operations in either the United States or NICs such as Brazil, as the latter had much lower labour costs than even Canada.

The second respondent with serious reservations, representing a producer of major appliances, wrote the following:

> We would reduce the size of our Canadian affiliate significantly and minimize investment if not cease altogether. If we maintained a manufacturing operation in Canada, it would produce a very limited range of products perhaps a low volume, niche-type product that could be sold in the United States. Perhaps a product that would not be attractive to manufacturing in the United States but would be in Canada.

The respondents for two other major-appliance manufacturers were, however, more favourable to the optimistic argument. Both acknowledged that the Canadian subsidiaries were significantly less efficient than the parents. FTA would probably induce them, however, to eliminate the efficiency differences.

One of them emphasized the importance of a sufficiently long transition period in FTA that would allow for gradual rationalization of the parent's Canadian operations. If the 12.5 per cent Canadian tariff were eliminated immediately, the parent might be forced to sharply curtail its activities in Canada, which could lead to the dismissal of 20 to 30 per cent of several thousand Canadian employees. Rationalization would require considerable new investment in robotics and automation.

As part of the rationalization, introducing FMS/CIM would (1) reduce the significance of the scale factor, (2) lower labour costs (as well as employment), and (3) improve the quality of existing models and make possible the introduction of new computer-controlled models (now produced only in the United States). Then the

Canadian subsidiary might be given WPMs for certain special-type products aimed at niche marketing. The new investments required would entail, however, high risk for the parent in terms of both the long-run value of the dollar and the durability of FTA itself.

The response from the third manufacturer of major appliances, who like the others had been recently facing Japanese competition and spending vast sums in rationalizing its U.S. plants, was very similar. Rationalization would be the first serious alternative to consider but the new investments required would have be justified from a long-run viewpoint. One could not make any specific predictions, especially when there was so much uncertainty about FTA itself. For instance, was it likely to include APTA-type Canadian safeguards for the rest of manufacturing?

Even after rationalization, the Canadian subsidiary would be most likely to manufacture specialty (low-volume) items with short production runs. It might be possible, however, to shift a few high-volume products to Canada with a North American mandate, especially if the already cheaper Canadian steel were to become much cheaper. For example, chest freezers, favoured by Canadian consumers, could be produced in Canada, letting the parent produce upright freezers favoured by U.S. consumers.

3. *Effects of Canadian and U.S. Government Policies Besides FTA*

The respondents were asked to distinguish between federal and sub-federal (provincial/state) policies—besides FTA—in the two countries. Most of them noted two basic differences: (1) in Canada both the federal and sub-federal governments played more significant socio-economic roles than their counterparts in the United States, (2) provincial governments in Canada were more powerful relative to the federal government than their state counterparts in the United States. These differences have been noted earlier by Morici *et al.* (1982, pp. 91-95) and Morici (1984, pp. 38-43 and pp. 55-58), and by the various testimonies contained in U.S. Senate (1986).

Although the first of these two basic differences was regarded as a mixed blessing by some, the second one was considered by most as disadvantageous to Canada. Moreover, the fate of FTA itself, whether it would be actually signed and successfully implemented, was seen as dependent largely on the provincial governments.

Many pointed out that trade was not yet free among the provinces themselves. The provincial governments had too much power in regulating inter-provincial trade as well as pursuing different intra-provincial socio-economic objectives in competition with each other. The state governments were not so powerful. Under the U.S. Constitution's commerce clause, the Congress had plenary power over both interstate and foreign trade.

The comment by one respondent for a capital goods producer summed up the consensus on the role of the provinces—especially their discriminatory procurement practices—as follows:

> Many of the provinces prefer to have products bought by government-owned industry made in their province. Hydro Quebec pays a small premium and gives preference to products made in Quebec. Similar policies are applied in Ontario by Ontario Hydro. Canada has to clean up its act between the provinces before being ready for FTA.

Several respondents argued that under FTA both federal and sub-federal Buy Canada and Buy America laws would ultimately have to be repealed. In discussing the relative roles of the two federal governments, many respondents indicated that there were a few benefits but several costs in the Canadian government's relatively bigger role. The regulatory environment was tougher and less favourable to business in Canada than in the United States. Although the present Canadian government was in general preferable to its predecessor, it was still not as sympathetic to private sector as its U.S. counterpart. The Mulroney government had been disappointing in many of its policies, failing to carry out fundamental changes, similar to those achieved by the Reagan administration, aimed at reducing the role of government.

No strong agreement emerged with respect to the effects of either federal or sub-federal subsidies and taxes on the respondents' likely decisions in the presence of FTA. Some said they would be of secondary importance as they had been in the past. Others, however, emphasized the importance of fiscal as well as social policies and argued that they should be harmonized as much as possible if FTA were to be implemented successfully. The respondent for a major manufacturer of consumer non-durables put it as follows:

> There will have to be considerable harmonization of laws and regulations between the two countries. For instance, deregulation of the Canadian transportation industry appears to be essential to achieving the more efficient, market-based allocation of resources that will bring the consumer benefits we anticipate. We also believe that some harmonization of regulations to protect human health, safety and the environment will be necessary if they are not to become serious NTBs to trade. This needs to be done in a way that does not undermine the protections they properly provide, but rather those differences that do not really provide benefits should be harmonized.

Some respondents argued that if they were to be able to fully integrate their North American operations, FTA would have to abolish specific NTBs. Manufacturers of major appliances singled out the different Canadian and U.S. standards for electrical products, set by CSA (Canadian Standards Association) and UL (Underwriters Laboratories), respectively. For example, although UL permitted the installation of a single fuse for all the elements in an electric range, CSA required multiple fuses. The CSA requirement added $35 to the cost of the range.

As for Canadian subsidies, one respondent complained about the Quebec government's power rate subsidy to new investors: it discriminated against old investors, he said. The old industrial users had to pay almost twice the rate charged to new ones. Another respondent's view on Canadian taxes was:

> Canadian tax breaks or duty remission programs for capital spending and investment in our Canadian operations would make marginal investments

> more economically feasible. In addition, a lowering of the corporate tax rate in Canada to a level closer to that in the new U.S. tax law would make investment in Canada more attractive.

(The Canadian government has already introduced a major tax reform bill, shifting the burden to a modified value-added type sales tax, in order to maintain competitive corporate and personal income tax rates with the United States—Urquhart, 1986.)

Several respondents expressed their opposition to all one-time or temporary subsidies as distorting their investment decisions and later destabilizing their operations. Full-fledged North American integration would require the elimination of all such subsidies. (Canadian subsidies under FTA are also opposed by National Foreign Trade Council (1986, p. 3).)

Many respondents complained about the higher rate of unionization and stronger power of Canadian labour unions relative to those in the United States. It was more difficult to fire workers in Canada. They attributed these differences largely to Canadian public policies. Canadian unions were seen as more rigid, for example, in terms of work rules and adapting to plant rationalization, than their U.S. counterparts. A few respondents mentioned recent serious difficulties in trying to obtain the decertification of their unions. This consensus confirms Morici (1984, p. 82) who notes that "labor-management relations pose more difficulties in Canada than in the United States."

Some respondents also noted, however, that the Canadian government's greater concern about labour had some benefits for them. The Canadian government paid fully the severance costs of employees when their plants were closed. This made plant closures relatively less costly in Canada than in the United States.

The consensus on U.S. "contingent protectionism" was that for FTA to be workable, the United States would have to revise its trade legislation in order to exempt Canada, as much as possible, from anti-dumping and countervailing duty (under Title VII of the Tariff Act of 1930 as amended) actions if not also from actions pertaining to unfair import practices (under Section 337 of the Tariff Act of 1930 as amended), unfair foreign practices (under Section 301 of the Trade Act of 1974 as amended), and safeguard ("escape clause") measures (under Section 201 of the Trade Act of 1974).

Excessive and unpredictable U.S. government intervention against Canadian exports would be self-defeating in establishing "a level playing field" under FTA. Hufbauer and Samet (1985, pp. 93-94) discuss how U.S. "contingent protectionism" might be limited *vis-à-vis* Canada. Rugman (1986c) argues that Canada's unhappiness with U.S. "contingent protectionism" as a troublesome NTB is at present a major reason for seeking FTA. In his recent testimony to the finance committee of the U.S. Senate, however, U.S. Trade Representative Clayton Yeutter called Canada's exemption from the above provisions of U.S. trade laws "an impossible request." (U.S. Senate, 1986, p. 50). The U.S.–Israeli FTA, signed in 1985, does not contain such an exemption for Israel.

A few respondents, in the iron and steel and timber inputs-based industries, disagreed, however, with that sentiment. They argued that their allegedly government-subsidized Canadian-based competitors, who had been penetrating their

U.S. markets unfairly, should not be exempted from any provisions of U.S. trade laws. Several respondents suggested that in any case a bilateral commission should be set up to arbitrate the trade disputes that were likely to arise during the implementation of FTA. This suggestion has also been offered by National Foreign Trade Council (1986, pp. 10-11).

Finally, several respondents voiced their concerns about the effects of third-country trade and direct investments, channelled through Canada, on their U.S. operations. FTA would have to include provisions, such as strong rules of origin based on minimum Canadian value-added levels and uniform Canadian performance requirements (if they could not be avoided), that prevented third countries from using Canada unfairly to penetrate U.S. markets. One respondent also noted "that it will very likely be appropriate to provide a common external alignment of the most sensitive or critical tariffs." Another advocated a full-fledged customs union, but believed that an FTA could probably be made to work.

4. *Changes Wished by U.S. MNCs in Canadian DFI Policies in the Presence of FTA*

In comparing the current DFI policies of the Canadian government with those in the previous years, especially during the Trudeau governments, almost all respondents saw improvements. Only a few had not experienced some difficulty, if not harassment, in dealing with FIRA during the last decade. (U.S. Department of Commerce—1985c—provides an in-depth analysis of Canada's DFI climate, on both the federal and provincial levels, as of October 1984.) Therefore, FIRA's replacement in 1985 by Investment Canada was welcomed. Those who had dealt with Investment Canada found it to be reasonable and occasionally even helpful.

In the words of one respondent, representing the views of close to half the firms in my sample: "Under current government policies, the discrimination against foreign firms is all but gone. A continuation of the present policies would be acceptable." Some of these firms regarded it as highly unlikely that Canada, given its sensitivities, would ever allow full national treatment to U.S. investors. Therefore, they did not insist that FTA be made conditional on that principle.

The rest of the respondents, however, expressed scepticism about the significance as well as the durability of the changes made. FIRA was gone but the Canadian mind-set that regarded the presence of U.S. investors with misgivings still persisted. This ambivalence had to be resolved under FTA. If Canada was serious about having a workable FTA, it would eventually have to adopt an open-door policy toward U.S. investors like the one the United States had toward Canadian investors. This open-door policy, like the present U.S. policy, might, however, restrict DFI in a few national security-related sectors.

The Investment Canada Act of 1985, which still gave too much discretionary power to the new agency, should be further liberalized. It would be much better to eliminate it altogether. The screening of all DFI projects, whether green-field or acquisition type, would have to be stopped. Performance requirements, such as local content, employment, R&D and export guarantees, which would interfere with effective North American integration, would have to be dropped. U.S. firms, whether they were already in Canada or going into Canada for the first time would have to be accorded the full national treatment.

One respondent expressed this common sentiment as follows: "We would like to be treated the same as Canadians, with no national ownership requirements." Without such complete reciprocity in the DFI policies of the two countries, it would prove very difficult to avoid serious frictions that might ultimately wreck FTA itself.

This strong emphasis on the principle of national treatment is also contained in National Foreign Trade Council (1986, p. 2 and p. 5), which recommends that the two countries should sign a bilateral DFI treaty as part of an overall FTA. (The National Association of Manufacturers has taken an identical position – U.S. Senate, 1986, pp. 100-101.) This treaty would include, besides the principle of national treatment, provisions on right of establishment, compensation for expropriation and transfer of funds. The United States has recently signed bilateral investment treaties (BITs) with several countries. (Recent official U.S. views on trade and DFI linkages and concerns about trade-distorting policies of other countries, including Canada, are discussed in Bale and Walters, 1986.)

V. Summary and Conclusions

This paper focused on only one of many possible significant effects of a comprehensive free(r) trade agreement (FTA) between Canada and the United States. It examined the potential impact of FTA on U.S. direct foreign investment (DFI) in Canadian manufacturing. Admittedly, this was a very difficult exercise because of both the shortcomings in our theoretical as well as empirical knowledge and the uncertainty surrounding the FTA itself.

The empirical analysis—based primarily on U.S. data—of the close bilateral trade and DFI relations, the strong trade and DFI linkages in terms of the intra-firm trade of U.S. multinational corporations (MNCs) revealed the importance of the potential impact of FTA on U.S. DFI in Canadian manufacturing. The review of the previous analyses of the impact found sharp differences of opinion, based partly on theoretical and partly on empirical evidence. These differences—called the **pessimistic** versus the **optimistic** arguments—seemed to yield diametrically opposite conclusions about the expected FTA-induced changes in the amount and nature of U.S. DFI in Canadian manufacturing.

The **pessimistic** argument predicted dire results in terms of massive U.S. disinvestment and substantial Canadian deindustrialization. Therefore, it either

opposed FTA for those reasons or advocated strong safeguards in FTA to avoid the dire results predicted. The **optimistic** argument, on the other hand, regarded those predictions as either unfounded or exaggerated. It foresaw, under FTA, largely beneficial changes in the composition if not also increases in the size of U.S. DFI activity.

The critical review of these two arguments—in terms of the several previous contributions made to the literature mostly by Canadian observers—found the **optimistic** one much more plausible. It concluded, however, that even the **optimistic** argument is mostly speculative and suggestive, not conclusive. Therefore, it should not be regarded as the single and unquestionable guide to public policy. As always in the real world, public policy would have to be made on the basis of far from perfect economic analysis as well as many non-economic factors.

Besides the support for the **optimistic** argument derived from the review of the literature, an informal survey of 28 U.S. MNCs with Canadian manufacturing operations yielded, on the whole, significant backing for the **optimists**. The survey obtained answers to four related questions, concerning the likely short-run to long-run responses of the parent firms to FTA.

The survey results, although varying among individual firms as well as different industries, could be summarized, subject to the several qualifications noted in Section IV, as follows:

1. In the short-run, FTA would stimulate parent exports, especially of finished goods, to Canada more than subsidiary exports to the United States. As long as FTA included a transition period, however, allowing for gradual adjustments, the consequences for the subsidiaries would not be drastic. This trend, favouring U.S. exports, would be weakened over time as the subsidiaries were rationalized and integrated with the parents on a North American basis.

   As they became more specialized and competitive, their exports to both the United States and third countries would increase. The continental rationalization of the U.S. MNCs would improve the international competitiveness of both Canadian and U.S. manufacturing.

2. Even for those parents whose Canadian subsidiaries were not at serious cost or quality disadvantages currently, FTA would be highly beneficial. It would allow for substantial increases in overall efficiency. Restructured regional production and distribution systems across the border would save costs and also enable certain currently undesirable regions to become more attractive as future plant sites.

3. Rationalization of many Canadian subsidiaries would be more likely **with** FTA than **without** it. Many parents, confronted with tougher global competition than ever before, at both home and abroad, were already restructuring their U.S. operations. For some, this involved scaling down if not phasing out their Canadian activities. FTA would make it much more attractive to include the Canadian subsidiaries in the restructuring. In other words, the *status quo* in Canada might not be sustainable indefinitely. In that sense, the **pessimists**

could be too optimistic about the consequences of keeping the Canadian branch plants protected from U.S. competition!

4. Under FTA, the most likely first response of the parents would be to rationalize not to close the branch plants in Canada. Plant closures were seen as drastic measures with substantial costs. Rationalization would involve greater specialization and longer production runs. New product models, mostly low-volume niche-types, would be introduced for sale in the entire North American market, if not also in the rest of the world. Cutting costs and improving quality could in some cases require significant automation in terms of CIM/FMS. This might reduce employment.

5. The future of FTA would depend to a large extent on reducing differences in the powers and interventions of both the federal and sub-federal (state and provincial) governments in the two countries. It would be essential to establish a "level playing field" by reducing if not eliminating discriminatory government practices on both sides, for example, Buy Canada or Buy America procurement policies, various types of Canadian subsidies, and U.S. "contingent protectionism." The two countries would also have to make sure that FTA did not enable third countries to use Canada to penetrate the U.S. markets unfairly.

6. For the success of FTA in keeping and attracting U.S. direct investors, Canada's overall business environment would have to improve relative to that of the United States. Canadian federal and provincial governments would have to further relax the tougher regulatory restrictions on business as well as reduce their generally larger roles in economic affairs. Canadian labour-management relations would also have to change for the better, especially with the elimination of Canadian public policies that favor labour against management.

7. Although Canadian public policies and attitudes toward U.S. direct investors had improved recently—especially after the replacement of the Foreign Investment Review Agency (FIRA) with Investment Canada in 1985—much more would be needed. Ideally, Canada should adopt an open-door policy toward U.S. investors like the one the United States had toward Canadian investors. Such reciprocity, under which U.S. investors would be accorded national treatment, might prove essential to making FTA workable. The screening of U.S. DFI projects, imposition of performance requirements, and other forms of discrimination against U.S. subsidiaries—which had vexed U.S. MNCs during the last decade—would, if continued, make it difficult for the branch plants to be fully rationalized and integrated with their U.S. parents.

8. Most respondents strongly supported FTA but believed its chances to be less than 50 per cent (during the late summer and early fall of 1986). Their pessimism about its future was based on the growing political opposition and the weakening government resolve in Canada, the lack of public interest in the United States, and the anti-FTA activities of powerful special-interest groups

in both countries. (U.S. Senate, 1986, contains the views of several such U.S. groups.)

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III.

American Federalism and Trade: The New Federalism and Economic Change

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A Brief History

Despite its place as the leading international trader in the second half of the twentieth century, the United States is unaccustomed to a national or governmental role in the world economy.[1] By ideology, tradition, history, and constitutional arrangement, national expectations adhere to the pre-eminence of private enterprise. American presence in trade is defined by American corporations and American-based multinational corporations. Government's traditional role has been to facilitate the activities and enhance the interests of the private sector by structuring rules that assure fair competition or protection.

Few American economic interests are associated with public enterprise. Nevertheless, some industrial sectors are so dominated by a small number of powerful corporations that American economic policy easily reflects their interests and the line distinguishing the public from the private sector is blurred.

Early in this century American international economic policy amounted to little more than periodic tariffs imposed on imports to protect American industry and a benign view of American corporations selling their wares abroad. The United States Senate defined both sets of rules.

Later, when other countries became more competitive and protectionism invited damaging retaliation, the Senate looked to the president for the negotiation of agreements that would enhance free trade or create reciprocal protections. The initiative

for a world economic policy came from the legislative and executive branches of the federal government and from the private sector.

While American authorities confined themselves to setting or negotiating rules, foreign authorities took on a more aggressive role in the international economy. Governments negotiated on behalf of national corporations; government officials promoted particular industries or companies in which the state had a direct stake. While American officials were preoccupied with international security in traditional terms of national defence, foreign officials were defining their security economically, attempting to sell the goods manufactured in their countries to the United States. Western Europe, Canada, and Japan all developed elaborate and sophisticated bureaucracies devoted to improving trade balances. The United States government generally left these activities to the great corporations.

With growing trade deficits, attributable partly to the conduct of and continuous preparation for foreign war, and partly to the appetite of domestic consumers, the United States government began to recognize that small and medium-sized enterprises were ignorant of the international trading system and competed less well domestically with the flood of foreign imports. And the large corporations alone could not sell enough in the international economy to control the growing deficit or withstand effects of foreign competition.

These developments thrust upon the federal government a greater responsibility to defend the country's economic interests. The Office of the Special Trade Representative was created to answer directly to the president and to confer a greater responsibility than ever before on the federal government in the national effort to protect jobs by increasing exports and deterring imports.[2] The Foreign Commercial Service, evolved from enhancing the interstate movement of goods within the United States, was phased exclusively into an aide of American exports. Other executive agencies, including especially the United States Department of Agriculture, initiated various programs to sell American products. But activities remained limited, largely confined to the executive and legislative branches of the central government.

By the mid-1970s, American economic discourse reflected a wistful hope for a national industrial policy that somehow would identify and help the sure economic "winners" while recognizing and leaving the likely "losers" to wither.[3] Alternatively, often the same political interests sought protectionism that would stem the tide of foreign imports. There was still little sense of a strategy for improving the export of American goods and services, save for some notion of reciprocity to be negotiated by the special trade representative, and belief in a link between the choice of "winners" and their likely success in international trade.

Whereas the national statistics were disquieting, the political impact was felt more at the state level. Governors were held accountable for unemployment, which could be interpreted as resulting from the decline in American competitiveness at home and abroad. Concomitant to the appeal for a national industrial policy was the lament of a regional "deindustrialization" of the United States.

Governors invariably claimed economic success as the product of their own efforts and blamed failure on federal policies and programs. The governors said they created jobs and national policies deprived their state of jobs. Either the state's companies competed successfully because the governors developed affirmative programs, or they failed because the federal government failed to protect them from foreign imports. The end of the Carter presidency was marked by this perspective from the individual states.

The "new federalism" compounded the burden.[4] With unemployment came welfare benefits, to be paid by the states. The states were to shoulder federally created programs, or give them up. Essential economic responsibility focused more on the states, but governors saw few instruments of government with which to respond.

Governors understood the international pressures building on their administrations because international economic developments passed through a benign federal government, with few policies or programs of its own, to leave them with imports and unemployment.[5] Many responded that there was nothing they could do. Some others renewed their plea to Washington. But most decided to become directly involved in the international economy. If their political futures would rise and fall according to the international economy, and they could not rely on Washington to protect them, then they would have to protect themselves.

The unmistakable language of the United States Constitution and the traditions of American political practice had confined international involvement overwhelmingly to the president and Congress. Federal government prerogative in foreign relations was beyond dispute. But in the 1980s state participation became decidedly more pronounced, and a transformation in the American institutional approach to the international economy got under way.[6]

State Capacity and Expenditure

State projection on to the international screen coincided with a growing state capacity to meet the challenge. State government had atrophied after World War II, challenged frontally in the south by the civil rights movement and weakened everywhere by a growing dependence on federal money caused by the explosion of Great Society programs in the 1960s. But states had to compete for federal support as the war in Vietnam absorbed resources and the Nixon administration began withholding congressionally mandated funds. Sophisticated state bureaucracies emerged to prepare grant proposals, negotiate with federal counterparts, and manage programs.

State bureaucracies mirrored the federal government. They began attracting new talent. They were integrated into more complex state governments, with cabinets serving governors in a host of activities. And they took on greater responsibility for the economic well-being of the state. As the Reagan administration struck down programs and

devolved others on to the states, the states had to develop the capacity to continue popular programs that had been started by the federal government, or give them up.

When trade deficits grew and plant closings in traditional major industries mushroomed across the country, state governments recognized that appeals to the federal government would not insulate them from the electoral wrath that would come from a failing economy. Usually, they promoted local programs, including assistance to industries to locate suitable land sites and to run the governmental gauntlet for construction, development, and operational approvals. But it was not long before they understood a need to go beyond state borders to locate and entice industry, or to generate revenues by selling state products elsewhere, especially outside the country. Thus was born much of the international activity of the several states.

State involvement came in financially hard times. State budgets were shrinking. Nevertheless, priority was given in some states to efforts in international trade and investment, and in many others programs were introduced despite pressures to treat them as less important than established domestic programs. Budgetary commitments often were made directly through the governor's office, but legislatures usually approved, often with specific mandates.

There can be no confidence in assertions about state expenditures in international trade, despite the efforts of some scholars arguing that the states have outdistanced the federal government. The National Association of State Development Agencies (NASDA) publishes statistics that reflect the budgetary commitments of state development agencies but neglect the activities of state offices devoted to tourism, agriculture, and even investment. And there are many gray areas. Louisiana, for example, voted a US$150-million bond issue for export loan guarantees. Is that a state expenditure? California expects a US$5-million loan guarantee program with direct state funds from the legislature in 1987; should those funds, theoretically not to be spent, be counted as state expenditure?

There are many other difficulties in defining expenditures. Many states have established offices for international trade and investment, but rarely do they cover all the state's activities in this field. State departments in trade of agriculture, for example, finance participation shows, some of which are international, usually with a budget that does not distinguish the domestic from the foreign program. Tourism programs may be incorporated into the international trade office, but usually they are on their own, with budgets that do not distinguish promotions in the United States from efforts abroad. Trade and investment may be handled in one office, or it may be split into separate efforts.

Budgets for state offices abroad sometimes are clearly identifiable, even specified in a legislative mandate (such as Oregon's Japan Representative Office). But often personnel from an agriculture department may be seconded to an office abroad. The foreign office is financed through the international trade or economic development department at home, and the officers appear on agriculture's books as regular personnel; the agricultural representative's budget for foreign activity may not show up anywhere. Travel budgets for foreign missions often are folded directly into overall travel budgets

that may include, for example, meetings in Los Angeles for officials based in Sacramento. Hence, it is possible only to approximate even these relatively distinct budget items.

Despite these hazards in determining state expenditures, international programs seem to range from commitments of at least US$100,000 to US$7 million or more (Table 1). West Virginia claims no expenditures on international trade and Idaho, Maine, New Hampshire and South Dakota each report spending less than US$100,000. In all, however, state governments seem to be spending in the aggregate at least US$50 million annually for international trade. They have opened some 70 offices abroad, typically with two professional staff and two support staff (see Tables 2 and 3). Smaller states, especially in the south, depend primarily on locally engaged personnel; more affluent states often send one or two professional staff of their own or hire a former state resident already living abroad. The cost of these offices ranges from US$100,000 to California's commitment of US$500,000 for each of its planned offices in Tokyo and London.

Of course, there are other state actors not counted here. Port authorities and cities, often with explicit state approval, have offices abroad seeking business, and in some instances they have been active longer than the state governments. Sometimes, as in the case of the port of Mobile, Ala., they see themselves serving state-wide interests. Officials in a governor's office, or more typically now the lieutenant governor's, often devote considerable time to international issues, whether due to a sister relationship with a foreign province or state, or because they are preparing a governor's trip abroad.[7] There is no reliable way to calculate the value of the time of officials not normally or specifically assigned to international affairs when they are so engaged.

What the States Do

The primary activities of the states abroad involve selling state products and attracting foreign investors. However, many states have established sister partnerships with foreign governmental units, most recently and especially with the People's Republic of China. Many of these arrangements are symbolic, but some plainly are active and imply budding economic relations.

The twinning relations are particularly notable because they suggest a considerable sophistication. States look for foreign states or provinces with complementary industries and economic needs. They integrate social, cultural, and educational exchanges with economic programs, as in Michigan's establishment of a model dairy farm in China's Sichuan province. And they are vulnerable to criticism precisely when such complementarity has not been achieved and prospects for economic enhancement are few.

Although state economic development departments typically lead international trade programs, they rarely enjoy exclusive domain. These departments, along with other departments and agencies, spend their money on publishing brochures, newsletters, directories, and surveys, on market studies and direct counselling for the development of

new markets, on matching buyers and sellers, on seminars, conferences, and training sessions for exporters, on loan guarantees and other export assistance, on foreign offices and agents, on trade shows, missions, and catalogue shows. The mix varies from state to state, as do the proportions of budgets expended in any one area or another.

Many of the state programs overlap federal efforts. In many instances, such as the states of Washington and Oklahoma, there are deliberate joint programs with the United States Foreign Commercial Service. These programs concentrate typically on first-time exporters, helping them to find markets and operate internationally. And Washington's Export Assistance Office, for example, searches for federal financing for Washington's small businesses seeking to enter international trade.

Many state offices fashion themselves as two-way conduits for foreign and domestic businesses. Pennsylvania, for example, "helps foreign buyers contact appropriate Pennsylvania companies, and also plans and arranges visits to Pennsylvania for foreign business representatives." A similar matching program is pursued by Florida's Agricultural Export Division of Marketing. South Carolina's Department of Parks, Recreation and Tourism began in 1980 to concentrate on attracting Western Europeans to visit the state. The effort included retaining an expert to represent the state in Europe, complementing the state trade office in Brussels.

State officials everywhere deny that the educational boost provided to new exporters subsidizes American businesses in any way. They also deny offering special incentives for potential investors, with many citing state constitutional prohibitions or the imposition of a unitary tax (repealed now nearly everywhere, most recently in California). Nevertheless, there are various packages of tax relief and other incentives, and although these offers are aimed at investment their potential impact on trade, generating new export business, is unmistakable.

State efforts, then, are focused primarily on economic development through trade and investment. The states insist they engage in promotion, not policy. Nevertheless, their economic efforts often become part of a more general foreign policy. Oregon and Washington have fashioned two-China policies; California is divesting holdings in companies conducting business in South Africa. North Dakota openly defied State Department advice when choosing to call Taiwan the "Republic of China" because of a discernible economic advantage.

Where is the Effort and Who Makes It?

The states began their efforts in the 1950s and 1960s, concentrating on Western Europe. In the 1980s, the number of state offices abroad has more than doubled, and most of these offices have opened in Asia, particularly in Tokyo (26), Singapore, Seoul, and Hong Kong (Tables 2 and 3).

Notably, little state effort is aimed at Canada. Although Canada is one of the four leading foreign investors in the United States (and if portfolio investment could be calculated reliably it might be the foremost), there are many complaints in the states that Canadian investment is non-productive, buying real estate and not creating jobs. And trade barriers, real and imagined, are cited often for failure to market goods in Canada systematically, especially in agricultural products and wine. Only four state offices are in Canada, two belonging to New York, and one each to Vermont and Georgia. Washington, Oregon, and California officials all cite Expo 86 as the incentive for their first active involvement with British Columbia, and California in part because of prodding from the White House; none has an active program for selling goods across the Canadian border, nor has British Columbia a coherent program looking south. Both the Canadian province and these three states look to the Pacific Rim and neglect each other. They do not think of each other as Pacific Rim countries.

Hence, despite the volume of Canadian-American trade and investment, and despite the explosion of state and provincial economic promotion internationally, many market opportunities seem to be missed because few efforts are made transborder. Moreover, the provinces tend not to recognize the states as avenues for trade, and the states perceive the provinces more as competitors than as potential partners abroad.

Although active border programs exist between most Canadian provinces and neighboring American states, the Canadian federal government has never recognized provincial-state relations as a vital dimension of Canadian-United States relations. Provinces frequently implement federal agreements, but when problems arise the federal government does not turn to the provinces for mediation. Instead, Ottawa prefers to concentrate on the White House and Congress. The states, perhaps consistent with the experience across the border, tend to look to Washington to resolve disputes with Canada. Although most trade is geographically transborder and most disputes arise there (potatoes or fish in Maine and the Maritimes; softwood lumber, shakes and shingles in British Columbia and the Pacific Northwest; hogs on the Prairies), the creative agreements that exist between provinces and states have not been important in settling grand trade issues. Hence, the states have defined for themselves a role in promotion and development, but on the North American continent have pretended not to make policy.

Although some of the largest and most affluent states lead in expenditures on foreign programs (especially California, Illinois, Michigan, Ohio, New York and Florida), Georgia ranks fourth in the country and five of the top 17 states are in the south (Georgia, Maryland, Alabama, Virginia, and North Carolina). Moreover, port authorities representing Maryland, Virginia, and Alabama are among the longest-standing international actors and do not figure in these results at all. Eleven southern states maintain 30 offices abroad (although usually by hiring consultants or local personnel); the only other region of the United States that approximates such a commitment 17 embraces five industrial states on the Great Lakes, with 13 foreign offices (five belonging to Illinois) among them. Yet these 11 southern states spent in 1985-86 approximately US $13.5 million on international activities; the five Great Lakes states spent US $11.6 million (Table 4).

Minnesota concentrates on industrial and cultural relations through offices in Oslo and Stockholm. Each of the other Great Lakes states has at least one office in Asia and one in Europe. Illinois has three Asian offices, plus offices in Brazil and in Brussels. None of these states has an office in Canada; Florida and Georgia do.

The northeastern states rely on the goodwill of the Conference of New England Governors and Eastern Canadian Premiers. There is little other transborder effort for trade or any other international programs, and little is spent elsewhere abroad. The average international expenditure for Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont is only US$728,400, only slightly higher than the average expenditure of the plains states (Indiana, Iowa, Kansas, Missouri, Nebraska, and South Dakota). When the three most affluent and populous states are removed from this calculus in the northeast (New York, New Jersey, and Pennsylvania), the average expenditure collapses to a paltry US$174,300. The six New England states have but four foreign offices combined. The plains states, moreover, rely on commodity groups, which spend substantial sums directly through the private sector to promote exports.

Over half the states have offices abroad and spend at least US$500,000 a year on international activity. When overall state budgets are compared to international expenditures, only Georgia is among the top ten spenders but outside the top ten states in overall budget. Regionally, the Great Lakes states report the most programs and missions abroad, but the southern states have bought the most foreign representation for the amount of money they spend. The greatest disproportion between state budget and state international expenditure is in Massachusetts, which also shows unfavourable results in promoting and attracting business. Although sixth in total budget, Massachusetts ranks twenty-eighth in international expenditure, and twenty-ninth in quantifiable results (Table 1).

Some states work very little with federal services in the United States or with embassy and consular services abroad. Many see themselves on their own, running their own programs and promoting their own interests. Few interact with other state offices abroad (although organizations for state offices in Brussels, London and Tokyo do convene regularly in the embassies and trade shows often are mounted cooperatively), and there has been little communication among states about their programs, especially at home, despite NASDA and other coordinating bodies. In large measure the absence of coordinating mechanisms within the states themselves makes the presentation of an overall state profile impossible and the consequent potential exchange of information incomprehensible. There is little cooperation among states, often because political incentives are defined within state borders and often because, outside the National Governors Association, there are few systematic arrangements for such interaction. When foreign business comes to Vancouver, Washington, for example, there is little satisfaction across the Columbia River in Portland, Oregon. Consequently, the number of voices in foreign policy and competitors in international trade indeed is multiplying.

Despite the obvious flurry of activity, the states do not have the resources to be particularly thorough or careful. No apparent political risk analysis is undertaken, and the choice of locations for activity therefore ranges from quixotic to a herd mentality (as

in the proliferation of offices in Tokyo). The Reagan administration's desire to encourage state takeover of many Foreign Commercial Service activities may increase the significance of the states in foreign trade, but it may also impose upon them a burden they are not prepared, and may never be equipped, to shoulder.

What are the Limits of State Sovereignty?

Article 1, Section 8 of the United States Constitution gives the federal government power "to regulate commerce with foreign Nations," and Article 1, Section 10 forbids states from entering "into any Treaty, Alliance, or Confederation" or "Agreement or Compact with another State, or with a foreign Power. " Article 1, Section 10 does not forbid the states from regulating commerce, and the states have made numerous economic, cultural and educational agreements abroad.[8]

The case law in this area is ambiguous. State taxes imposed on foreign corporations consistently have been upheld, most recently in *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1, 1985. But Louis Henkin has observed that

> What the Commerce Clause forbids and what it permits the States has splintered the Supreme Court, and has filled volumes of law, not all of it clear or consistent.[9]

And Henkin also has noted the ways in which the States always had " impinged on American foreign relations:"

> They regulate and tax commerce with foreign nations. They regulate the rights of aliens.... State courts apply state law and policy in deciding whether domestic law or foreign law should apply to a trans-national transaction; whether to give effect to a foreign act of state that imposed a tax or penalty, or was criminal in character, or confiscated property outside its territory; whether to enforce the judgment of a foreign court.[10]

The Supreme Court's 1968 decision in *Zschernig v. Miller*, 389 U.S. 429 (1968), Henkin contends, breaks new constitutional ground by claiming state intrusion upon federal powers even when federal branches had not acted or objected. Writing in 1972, he anticipated movement toward more federal assertion over state international initiative. Such a trend, however, did not develop.

State international activity has increased so profoundly that the federal government simply has abandoned the notion of enforcing strict constitutional interpretations. Even in 1972 Henkin wrote,

> While, in principle, all these local contacts with foreign affairs might be brought under national control by federal law or international agreement, that could not begin to be done and there has never been any disposition to begin to do it.[11]

Moreover, the states more cavalierly ignore State Department advice as they measure their own objectives. North Dakota designated Taiwan as the "Republic of China" despite such advice. Concern for such a conflict between federal policy and state wishes won little sympathy in the California legislature's 1986 debate over a similar measure. And knowing the federal government's objection to divesting holdings in South Africa, California's legislature voted to divest all state monies, including the state university system's endowment.

Despite the formal constitutional limitations, it is impolitic and impractical for the federal government to constrain state activities abroad, especially where the states are working for economic advantage. The various agreements and compacts may well violate the Constitution's express prohibitions, as may the states' competitive incentive packages attracting foreign investment, which appear to violate the dormant Commerce Clause. But these activities have so expanded and acquired such a life of their own that it is no longer possible to count them, let alone bring them under control.[12]

The federal government, then, is unquestionably supreme in the international arena, but the states are exploiting every constitutional ambiguity and even defy federal preference when they think it in their best interests. The constitutional limits on state sovereignty control very little state activity. There are few effective limits in the economic arena of international affairs.

What Does it All Mean?

These developments in American federalism have at least four main consequences: they multiply the brokerage mechanisms of foreign policy; they multiply American voices abroad; they change the traditional role of governors; they diversify foreign relations.

Foreign powers used to look only to the president of the United States. Senate rejection of treaties encouraged them to discover Congress, particularly the Senate. But even foreign leaders most intimate with the United States have difficulty comprehending the intricacies of American federalism. The prime minister of Canada, for example, has discounted the value of access to the Speaker of the House of Representatives, and Canadian trade negotiators have rejected any importance in dealing with American governors.

Governors and congressional delegations talk often. Senators and congressmen want to know what governors think to be in the best interests of their states. Washington Governor Booth Gardner, a self-avowed free trader, sympathized little with the shakes and shingles lobby in the summer of 1986, so the lobby went directly to Congress and the Administration; interested parties ignored the governor, and perhaps also ignored an opportunity to derail the lobby's influence.

Because governors are interested and involved, they represent a new channel of communication on international trade and a new mechanism for brokering interests.

They have been mobilized rarely, yet 36 of them maintain their own offices in Washington, D.C., primarily to lobby on Capitol Hill. Only California's governor is served in Washington by an official monitoring issues of international trade, but many other states look to her and to the National Governors Association, located in the same building, to keep them informed and help them protect their economic interests. Grand policy voting still resides in Congress, and major negotiations remain in the hands of the president, but state support is growing in importance and potentially can be mobilized to great effect.

This brokerage change transforms the role of governors. They are now international actors as they have never been before. Forty-six of them have called on Ambassador Mike Mansfield in Tokyo, and most travel abroad on official business at least once every year. Despite complaints, typically from federal officials, that these outings may be junkets, evidence indicates they are hard-working trips aimed at selling state products and soliciting foreign investment. The governors thus serve as roving ambassadors for their states, and even for the United States. They are able to present themselves in American politics as more competent than ever before to deal with foreign affairs.

The governors do not depend on federal policy when they decide where to travel. They take few federal cues about when to travel, or where to send delegations, or what to say. Although they do not pretend to speak for the United States, the governors of California, Illinois, and New York certainly speak for a large portion of the country. They multiply American voices abroad, and so far there is no alarm in Washington, D.C., about this development. Precisely because Washington accepts the governors in such an expanded role, foreign partners need to recognize their new significance.

The states are able to explore economic opportunities more freely than the federal government. Unencumbered by tradition, security, or diplomacy, they can seek economic advantage wherever they please. They can open and close small offices almost at will, and sometimes they do. Hence, they are able to diversify American foreign economic relations with much greater speed, and potentially with much greater effect, than the federal government.

There is no simple way to measure the impact of these changes. It is never possible to know with confidence whether a foreign investment is attracted because of the presence of a state office, or because of a sister relationship with a foreign province, or because a governor placed his prestige behind a trade mission. Nor is it possible to know whether incoming foreign investment will educate and train workers for more general economic improvement, which officials in many states claim. But in fiscally constrained times the overall direction of state commitment to international trade is clear. Governors plainly believe their own investment in these endeavours is rewarding, and the national psychology has turned away from accusing governors or state officials of overreaching or enjoying junkets when they develop international relations.

Americans obviously believe in international trade more than in the past; where budgets are most visible, at state and municipal levels, they are endorsing expenditures, even when officials warn that payoffs may not come for five years or more. And the

federal government is permitting, even encouraging, initiatives at the state and municipal levels, hoping to reduce federal responsibility and expense. These developments, internationalizing state government, transform the presentation of the United States abroad. And they invite foreign partners to discover new ways to deal with the United States.

Notes

1. On the U.S. role in the world economy since 1945, see: Robert Z. Lawrence, *Can America Compete?* (Washington, D.C.: Brookings, 1984).

2. For information on the development of the Office of the Special Trade Representative and a review of the governmental actors involved, see: Executive Office of the President, United States Trade Representative, *A Preface to Trade* (Washington, D.C.: Office of the U.S. Trade Representative, 1982). See also: *Annual Report of the President of the United States on the Trade Agreements Program, 1984–1985* (Washington, D.C.: U.S. Trade Representative, 1986). For information on the trade promotion efforts of the Department of Commerce, see the magazines sponsored by the International Trade Administration: *Business America, The Magazine of International Trade and Overseas Business Reports.*

3. See Robert B. Reich, *The Next American Frontier* (New York: Times Books, 1983); and Barry Bluestone and Bennett Harrison, *The Deindustrialization of America* (New York: Basic Books, 1982).

4. On the "new federalism" and questions of economic development, see: The Committee for Economic Development, Leadership for Dynamic State Economies (New York: Committee for Economic Development, 1986); and Marianne K. Clarke, *Revitalizing State Economies* (Washington, D.C.: National Governors Association, 1986).

5. The key work which makes the connection among federalism, economic development and international trade is: Dewitt John, *American Federalism in a Turbulent World Economy Development* (Washington, D.C.: National Governors Association, forthcoming, 1987).

6. The most comprehensive review of state international economic activity is: John M. Kline, *State Government Influence in U. S. International Economic Policy* (Lexington, Mass.: Lexington Books, 1983). For an abbreviated version, see: "The International Economic Interests of U.S. States," *Publius*, vol. 14, no. 4, 1984.

7. For the role of governors in international questions, see John Kincaid, "The American Governors in International Affairs:, *Publius*, vol. 14, no. 4, 1984. See also, John Kincaid, *Constituent Diplomacy: U.S. States Roles in Foreign Affairs*, paper presented to the World Congress of the International Political Science Association, Paris, July, 1985.

8. A review of some of the constitutional issues can be found in Robert F. Meagher, *The States and International Economic Relations*, speech to the Conference of Western Attorneys General,Santa Fe, New Mexico, July 18, 1986.

9. Louis Henkin, *Foreign Affairs and the Constitution* (Mineola, N.Y.: The Foundation Press, 1972), p. 235. Chapter IX on "The States and Foreign Affairs" is particularly useful.

10. *ibid.*, p. 238.

11. *ibid.*, p. 244-245.

12. The activities of the states, particularly in the Pacific Rim, did give rise to Congressional concern regarding their potential for conflict with the federal agenda in international economic questions. See: Hearings before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce. House of Representatives, 98th Congress, 2nd session, *Federal, State, Local Government and Private Sector Activities and Cooperation for Increased Export Development*, December 6 and 7, 1984 (serial no.: 98-191).

Table 1
RELATIONSHIP OF EXPENDITURES ON FOREIGN ACTIVITY TO TOTAL BUDGETS

Rank order of states by level of spending on foreign activities (INTR) compared to the 1983 rank for all state spending (TOTR). The rank order of results (RESLTR) is calculated from the rankings of the states on dollar value of agricultural exports, manufactured exports (1981/82 data), and foreign investment within the state (1985 data).

State	#	$ for 85/86	INTR	TOTR	RESLTR
California	0	7,150,000	1	1	1
Florida	3	3,600,000	2	8	12
Illinois	5	3,355,000	3	3	3
Georgia	4	2,693,000	4	15	14
Michigan	2	2,600,000	5	10	6
New York	5	2,500,000	6	2	10
Ohio	2	2,500,000	7	5	4
Minnesota	2	2,202,200	8	13	9
Washington	1	1,940,000	9	16	8
New Jersey	0	1,700,000	10	7	17
Virginia	3	1,445,800	11	18	21
Maryland	2	1,400,000	12	19	31
Iowa	2	1,355,000	13	26	19
Missouri	2	1,251,000	14	22	15
Pennsylvania	4	964,000	15	4	13
Alabama	6	950,000	16	27	22
No. Carolina	2	950,000	17	17	5
Wisconsin	2	937,000	18	12	18
Connecticut	2	900,000	19	20	33
Oregon	1	900,000	20	31	32
Alaska	2	740,000	21	14	42
Indiana	2	705,590	22	21	11
Utah	1	702,500	23	39	36
So. Carolina	2	650,000	24	24	20
Kentucky	1	582,900	25	33	23
Arkansas	1	540,000	26	37	27
Massachusetts	0	540,000	27	6	29
Mississippi	0	525,000	28	36	28
Louisiana	4	481,000	29	11	7
Arizona	0	477,900	30	29	24
Hawaii	0	285,000	31	33	43
Rhode Island	1	275,000	32	38	46
Texas	1	253,000	33	9	2
Colorado	0	220,000	34	30	25
Montana	0	200,000	35	47	37
Wyoming	0	200,000	36	46	38
Nevada	1	160,000	37	45	45
Delaware	0	140,000	38	41	35
Kansas	1	132,000	39	32	26
Nebraska	0	130,000	40	40	30
Vermont	1	125,000	41	48	46
New Hampshire	0	80,000	42	50	44
Maine	0	60,000	43	42	39
So. Dakota	0	51,000	44	49	40
Idaho	0	25,000	45	43	41

Table 2
ASIAN FOREIGN OFFICE LOCATION AND DATE OPENED

#	State	Tokyo	Hong Kong	Seoul	Other
(6)	Alabama	1981	1984	1985	
(2)	Alaska	1964		1985	
(1)	Arkansas				
(2)	Connecticut	1984			
(3)	Florida				
(4)	Georgia	1973		1985	
(5)	Illinois	* 1983	1974		1985 PRC
(2)	Indiana	1980			
(2)	Iowa		1984		
(1)	Kansas	1985			
(2)	Kentucky–1 closed	1983			
(4)	Louisiana	? 84-85			?84-85 PRC & Taiwan
(2)	Maryland	1980			
(2)	Michigan	1973			
(2)	Minnesota				
(2)	Missouri	1982			
(2)	Nebraska–closed	(1980)			
(1)	Nevada	1986			
(5)	New York	1964			
(2)	No. Carolina	1978			
(2)	Ohio	1976			
(1)	Oklahoma	1985			
(1)	Oregon	1984			
(4)	Pennsylvania	1981			
(1)	Rhode Island				
(2)	So. Carolina	1983			
(1)	Texas				
(1)	Utah	1984			
(1)	Vermont				
(3)	Virginia	1964			
(1)	Washington	1982			
(2)	Wisconsin		1986		
Totals		23	4	3	3
Total Asian offices		33			
Total all offices		69			
Number of states with Asian offices		25			

\# = total number of foreign offices
* = Osaka, not Tokyo

Table 3
NON-ASIAN FOREIGN OFFICE LOCATION AND DATE OPENED

#	State	Bruss.	Germany	London	Canada	Other	
(6)	Alabama		1982	1977		1974	Switz.
(2)	Alaska						
(1)	Arkansas	1976					
(2)	Connecticut		1975				
(3)	Florida		1984	1982	1980		
(4)	Georgia	1973			1981		
(5)	Illinois	1968				1976	Braz.
(2)	Indiana	(@1982)		1986			
(2)	Iowa		1976				
(1)	Kansas						
(2)	Kent.–1 closed	( )					
(4)	Louisiana			*1985			
(2)	Maryland	1977					
(2)	Michigan	1973					
(2)	Minnesota					83,84	Swed.
(2)	Missouri		1976				Norw.
(2)	Nebraska–closed		(1980)				
(1)	Nevada						
(5)	New York		1983	1963	(2)1962		
(2)	No. Carolina		1972				
(2)	Ohio	1976					
(1)	Oklahoma						
(1)	Oregon						
(4)	Pennsylvania		1981	1981		1981	Mex.
(1)	Rhode Island	1983					
(2)	So. Carolina	1975					
(1)	Texas					1971	Mex.
(1)	Utah						
(1)	Vermont				?		
(3)	Virginia	1954				1975	Braz.
(1)	Washington						
(2)	Wisconsin			1984			
Totals		9	8	7	5	7	

Total Non-Asian offices 36
Total all offices 69
Number of states with European offices 21

\# = total number of foreign offices
* = UK/France office in Southampton
@ = closed in 86 for move to London

Table 3 (continued)
NON-ASIAN FOREIGN OFFICE BY DATE OPENED

#	State	Bruss.	Germany	London	Canada	Other	
(3)	Virginia	1954				1975	Braz.
(5)	New York		1983	1963	(2)1962		
(5)	Illinois	1968				1976	Braz.
(1)	Texas					1971	Mex.
(2)	No. Carolina		1972				
(4)	Georgia	1973			1981		
(2)	Michigan	1973					
(6)	Alabama		1982	1977		1974	Switz.
(2)	Connecticut		1975				
(2)	So. Carolina	1975					
(1)	Arkansas	1976					
(2)	Iowa		1976				
(2)	Missouri		1976				Norw.
(2)	Ohio	1976					
(2)	Maryland	1977					
(3)	Florida		1984	1982	1980		
(4)	Pennsylvania		1981	1981		1981	Mex.
(2)	Indiana	(@1982)		1986			
(2)	Minnesota					83,84	Swed.
(1)	Rhode Island	1983					
(2)	Wisconsin			1984			
(4)	Louisiana			*1985			
(1)	Vermont				?		
Totals		9	8	7	5	7	
Total non-Asian offices		36					

\# = total number of foreign offices
* = UK/France office in Southampton
@ = closed in 86 for move to London

Table 4
FOREIGN EXPENDITURES FY 85/86: REGIONAL TOTALS

Pacific Northwest (n=4)
Total: $ 10,730,000
Average: $ 2,682,500
Offices: 4

(Alaska, Oregon, Washington, California)

Great Lakes States (n=5)
Total: $ 11,594,200
Average: $ 2,318,840
Offices: 13

(Illinois, Michigan, Minnesota, Ohio, Wisconsin)

Southern States (n=12)
Total: $ 14,070,700
Average: $ 1,172,558
Offices: 29

(Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Texas, Virginia [Oklahoma, Tennessee and West Virginia no data])

Northeastern States (n=10)
Total: $ 7,284,000
Average: $ 728,400
Offices: 13

(Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont)

Central Plains States (n=6)
Total: $ 3,624,590
Average: $ 604,098
Offices: 7

(Indiana, Iowa, Kansas, Missouri, Nebraska, South Dakota [North Dakota no data])

Western States (n=6)
Total: $ 1,507,500
Average: $ 251,250
Offices: 2

(Colorado, Idaho, Montana, Nevada, Utah, Wyoming)

Table 5
ASIAN FOREIGN OFFICES BY DATE TOKYO OPENED

#	State	Tokyo	Hong Kong	Seoul	Other	
(2)	Alaska	1964		1985		
(5)	New York	1964				
(3)	Virginia	1964				
(4)	Georgia	1973		1985		
(2)	Michigan	1973				
(2)	Ohio	1976				
(2)	No. Carolina	1978				
(2)	Indiana	1980				
(2)	Nebraska–closed	(1980)				
(2)	Maryland	1980				
(6)	Alabama	1981	1984	1985		
(4)	Pennsylvania	1981				
(2)	Missouri	1982				
(1)	Washington	1982				
(2)	Kentucky	1983				
(2)	So. Carolina	1983				
(5)	Illinois	1983	1974		1985	PRC
(2)	Connecticut	1984				
(1)	Utah	1984				
(4)	Louisiana	?1984			84-85	PRC
(1)	Oregon	1984				
(1)	Kansas	1985				
(1)	Oklahoma	1985				
(1)	Nevada	1986				
(2)	Iowa		1984			
(2)	Wisconsin		1986			
Totals		23	4	3	3	
Total Asian offices		33				

IV.

Three U.S. Hypotheses about Culture and Trade in Search of Canadian Validation

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I would like to propose three hypotheses about Canadian culture and the impact of U.S. trade, subject more or less to validation by the empirical research of contemporaries and to the logic of theoretical argument.

The first hypothesis is that Canadian culture is more fragile, more in the process of creation and less self-confident than that of many other modern societies, certainly than that of the United States.[1] By culture, I mean both what is often termed high culture and what is called entertainment. Together, high culture and entertainment provide the myths which along with historical experience and mass education underlie the structure of a society and of its political institutions. Culture is the cement that enlivens society, gives it its distinctiveness, and holds it together.

Canadian culture is more fragile and less self-confident than a number of other cultures for a variety of reasons. It is a society that has emerged out of the historical experience of two founding peoples, the French-speaking inhabitants of Lower Canada and the English-speaking members of Upper Canada.[2] Governing two comparatively homogeneous but separate cultural and linguistic groups within a single country is not easy. In addition, Canada is divided regionally and the population is distributed in such a way that geographic mobility and territorial interaction are very difficult. Population distribution in most countries is like a saucer in which communities are spread rather randomly across its surface. Population distribution in Canada hugs the lower edge of the saucer and corresponds to a thin line broken at various points by vast physical spaces.

Canada is also the product of a much closer socio-psychological association between segments of each of its population and the European mother countries France and Great Britain respectively than is, for example, true for the United States or for most of the

countries of Latin America with respect to Spain or Portugal. Quebecers are not Frenchmen any more than the sons of the United Empire Loyalists today are British. Yet the affinities with each of the European countries impede to some extent the emergence of a self-confident sense of cultural authenticity for some Canadians.[3] They do not feel French, nor British, nor do they want to be American; becoming Canadian is a blend of all of these traditions, and more, and it is a very gradual process.

Finally, Canadians live next door to one of the largest, most vital and most self-confident cultures on the globe today, that of the United States. American culture rubs off on Canada whether Canada likes it or not.

Canadians spend at least three hours a day, on average, in front of a television set. Two of those hours are spent watching drama. For English-speaking Canada, 98 per cent of that drama is American.[4] Three out of four books Canadians read are published from abroad, mostly from the United States.[5] Three quarters of the revenue earned in movie distribution within Canada is earned by foreign-controlled companies.[6] Is it surprising that Canadian schoolchildren sometimes confuse their own very different Senate with the U.S. Senate and their own RCMP with the American FBI? Is it surprising that Canadians want textbooks to have Canadian content and to transmit Canadian values? Is it unusual for the federal government in Ottawa and for many of the provincial governments to wonder about the myths that Canadian children learn and accept with respect to what being Canadian means?

Yet what Canadians want their culture to be is somewhat less clear than what they do not want. They do not want it to reflect American values.[7] After that the consensus seems to end. Even this minimal and somewhat negative definition of Canadian culture, because of its inwardness, is difficult to achieve. If Canadian culture is anything that American culture is not, the latitude is too broad (literally perhaps as well as figuratively) and too diffuse to make either insulation or containment a very credible strategy.

But, however difficult is the task of defining Canadian culture, and then of sustaining that definition of culture, the relevance of culture for the cohesiveness, self-confidence, and sense of legitimacy of the state is not at issue. Indeed the relationship between government and society essentially turns on the matter of culture.[8] For example the question of the degree of central control in the federal state, a perennial issue for political theorists as well as policy makers in Canada, cannot be analyzed apart from culture. Some analysts such as John Meisel argue that the more vital and cohesive the underlying culture of society, the less necessary are centralized political institutions; conversely, the less vital and cohesive the culture, the more necessary is the establishment of centralized political institutions to overcome possible fragmentation of the polity.[9] Some of the strongest proponents of the defence of culture of course do not see the issue of centralized federal authority in this way either because they do not value political unity highly or because they see culture at the sub-nation-state level (not sub-national level since this would imply that the "nation" is always synonymous with the "state") as having priority over polity-wide culture. But however one views the proper

relationship between societal culture and political authority within the polity, the relevance of culture to politics is scarcely to be denied.

This first hypothesis goes further than just the observation that culture is felt to be important by the opinion elite in Canada. The hypothesis asserts that Canadian culture is fragile, and though in the process of maturing, still uncertain of its content and direction. Since Canadian culture is tentative the sense of Canadian political identity is also, although perhaps less so than in the past, lacking a degree of self-confidence that affects its domestic political relations and even its capacity to conduct foreign policy. It has occurred to some observers in Washington, for instance, that a Canada more confident about itself in foreign affairs would be a Canada both less given to large visions unsupported by the capability to carry out those visions and more satisfied in its relationship with sizable but also rather awkward and benign trading partners.

In short, the first hypothesis expresses the often unspoken premise of the seeker of Canadian cultural sovereignty, namely, that Canada has a more complex and delicate sense of itself than many other advanced industrial polities and that this fragility and ambivalence is often transmitted to its political institutions which after all face a very large task in governing an essentially bi-national (I maintain, rather than multicultural) country. The hypothesis expresses a perception about Canadian culture, translated into the sphere of politics, that holds meaning for Canadian governability.

Hypothesis 1 Canadian culture is more fragile than that of many other rich, advanced-industrial democracies.

Hypothesis 0 Canadian culture is not more fragile than that of many other rich, advanced-industrial democracies.

Let me turn to a second hypothesis about Canadian culture that cuts in quite a different direction. My second hypothesis is that despite the fragility and tentativeness of Canadian culture, trade and commerce—even trade and commerce with its giant neighbour to the south—has very little to do with the kind and quality of culture that Canada evolves for itself.[10] Culture is transmitted by personal contact, and by ideas, not by goods and services. Even if Canada were to print every book read in Canada at home and were to insist that only made-in-Canada films were shown in Canadian movie houses and were to insist that every show on Canadian television had 100 per cent Canadian content, the rich cross-border flow of ideas, lifestyles, and personal interactions would continue to diffuse cultural notions. The only difference would be that a black market for foreign books would emerge, the sale of "satellite dishes" would multiply many-fold, and movie-houses would open up just inside the U.S. border to provide service to Canadians interested in popular American movies. Canada cannot isolate itself from the world culturally, much less from North America. Cultural attitudes and behaviour would remain fundamentally unaffected by this cultural revolution and its proponents would be appalled at the public backlash against so charitably motivated a set of public policies.

Goods and services through reputation and advertising can to some extent create their own demand although the demand for the most part is already inherent.[11] But goods and services are not designed to carry an over-burden of national content. Indeed,

insofar as possible the producers of goods and services would with rare exceptions (for example, perfume) prefer to manufacture products that are "value-free" culturally so as to make them as acceptable to the widest possible market at the lowest possible cost and therefore at the greatest potential profit. This is the reason that when Japanese companies enter the North American market-place they attempt to shed all vestiges of Oriental culture, making themselves appear to the average consumer as familiar and safe as a Sears-Roebuck catalogue.

If Canada under any plausible circumstance cannot isolate itself from outside cultural bombardment in any case, and if goods and services are not designed to convey cultural attitudes and instead frequently are designed to be as culturally unobtrusive as possible (despite the universal impact of technological change on culture that is not nation-state specific), then the cultural impact of an agreement freeing up some bilateral trade with the United States cannot be very climactic. Indeed, an agreement between Canada and the United States to expand trade and to enhance or free up trade is probably going to have very little impact on Canadian culture, positively or negatively.

Subsidies to the arts, the quality of the Canadian welfare and medical insurance systems, and research grants to scholars are not going to be on the bargaining table.[12] If erosion of Canadian cultural values does occur in the next decades, it will not be because of the nature of the trade package that Ottawa and Washington sign.

Admittedly the gambits of the trade negotiators did little to assuage the concerns of those who worry about the robustness of Canadian culture. But for tactical bargaining reasons the situation could hardly have been different. The objective of the American side was to put "everything on the table" or at least to appear to do so. In part this was because to start making exclusions early would enable American interests facing a much more fractious system of representation to force American negotiators to demand exclusions as well, thus shrinking the size of the potential trade arrangement to virtually nothing before the talks had even officially opened. Conversely the Canadian gambit was to limit as much as possible the scope of the negotiations so as to focus the talks upon what Canada most wanted namely guaranteed access to the U.S. market. This Canadian bargaining tactic was also employed, however, because the less that was on the table the easier the task of getting the provinces and other constituencies to go along with the eventual outcome of the agreement. The Canadian tactic of limiting discussion at the beginning made a great deal of sense in negotiating terms at home even if it directly challenged the preferred American strategy. Because the Canadian and American gambits were so apparently different, Canadian cultural defenders got the impression that more was at stake for them than ever possibly could have been true. Demarcation of the actual negotiating field narrowed possible discussion of cultural matters on two ends.

First, so-called high culture was safe from scrutiny. In both countries large state bureaucracies plus generous foundation and private or corporate donations support literature, the arts, and academia. A much higher percentage of this support comes from government, federal or provincial, in Canada than in the United States, revealing the different ethos toward societal responsibility in the two countries.[13] But the reality of support and the need for that support is a commonly understood value in both countries. Most of the support takes the form of grants or fellowships and may or may not be tax

deductible. Every facet of high culture and academic research receives this support in both countries because it is regarded as socially desirable and insufficiently funded through proceeds from the sale of the product. If the comparative cost of opera tickets in the two countries is any measure, the consumer in the United States is expected to foot a higher percentage of actual cost, thus generating welfare implications about who has access to this medium, but otherwise the commitment to support for this and other types of high culture in the two polities is remarkably similar: no one seriously contends in either the United States or Canada that, however cumbersome and judgmental the criteria and methods of support in the two countries, freer trade ought to be allowed to impinge on the process of support.

Second, and at the opposite end of the cultural spectrum, social programs exhibiting cultural preference as to implementation if not to direct impact on the generation of cultural output is an area of great importance to both societies.[14] As is so often the case, the two countries look at the management and content of social programs quite differently. In the United States, for example, the employee and the employer jointly pay the costs of many medical, retirement, and even life insurance premiums. In Canada, governments pay the costs of these premiums and programs directly, and often at a somewhat higher level of coverage but also, of course, at a higher cost to the taxpayer.

At a first level of generality, the foreign firm competing with a Canadian firm may then seem to be at a disadvantage because it must assume costs that in Canada are assumed by the government. At other levels of generality, however, if all the costs of competition are taken into account including actual labour costs and taxes, it is not at all clear that the foreign company and the foreign worker is at a disadvantage relative to the Canadian counterpart. In a recent case brought by American fishermen regarding alleged subsidy provided by more ample unemployment insurance policies in Canada to fishermen unemployed in the off-season this was exactly the conclusion that American trade officials came to accept. Canadian social and medical insurance programs are thus not at risk in any bargaining over trade matters with the United States. The United States does not seek to change the nature of these Canadian social programs any more than Canada seeks to alter the American programs. By the same token, however, Canadian cultural nationalists, when lamenting the sameness of value and the erosion of cultural distinctiveness in Canada, ought to acknowledge the presence of these quite different programs as an index of how different the cultural ethos of each country is and of how divergent the resulting programs and political structures of each polity are.[15] Either they are different, and are pillars of authenticity that deserve recognition, or they represent only wavelets of diversity in an ocean of sameness and are therefore not worth cherishing and are not of much consequence. The former view seems the more valid.

Thus some of the most emotional areas of the current debate over culture and trade in Canada are not on the bargaining table and never were. The term "cultural industry" is badly in need of definition. One attempt at definition includes (1) periodical and book publishing, (2) records, (3) film, and (4) video.[16] To this list most proponents of the cultural industry argument would add (5) broadcasting, both radio and television. While accepting this list as a base, and while acknowledging the strong foreign presence in many of these areas both in terms of direct foreign ownership and foreign control, most analytic outsiders will address a single question to the matter of protection for the

cultural industries: how much does each actually contribute to the vitality and authenticity of Canadian culture? In other words, where is the line drawn between what might be regarded as legitimate reinforcement for Canadian culture legitimately defined, and how much is superfluous protection not different in economic motivation than the protection all industries try to obtain at the expense of the consumer and of the trading system?

Neither the trading regime nor modern economic theory has evolved to the point where these questions of legitimacy can be answered with much precision.[17] Examples may however illustrate the problem. Does a cassette recorded in Canada of a British rock group contribute to Canadian culture? Do signals pirated off American television programming, stripped of the commercials that have paid for that programming, and then rebroadcast in Canada, add to the authenticity of Canadian television? Are textbooks in the hard sciences that are protected from having to face the best output internationally and nationally likely to be as of high a quality as those that are not so protected, and is this kind of "protection" genuinely helpful to the education of the next generation of science students in Canada? Is there anything innately Canadian or worth defending culturally in a movie such as *Porky's* which was a commercial success and would have been a commercial success regardless of subsidies? All of these questions raise doubts that in these specific instances at least anything more than an industry's desire for economic protection was at issue. The rubric of "protection for the cultural industries" encompasses unfortunately both legitimate and illegitimate support.

A microcosm of the debate over how to delineate legitimate support for the cultural industries from phony argumentation is the textbook publishing situation which because of the transfer of foreign ownership of the Prentice-Hall subsidiary in Canada from one American firm to another, thereby enabling Investment Canada to intervene, focused public and political attention on the culture and trade issue.[18]

At the heart of the textbook publishing situation is the assertion that Canadian-owned publishing houses publish a higher percentage of Canadian authors than foreign-owned houses.[19] Canadian authors supposedly write about Canada in a way that is more authentic than foreign authors. Authenticity transmits the correct set of values and perspectives, and therefore, so the argument goes, Canadian culture and society benefits from this higher percentage of Canadian authorship. At stake is not job creation for under-employed academics. At stake, according to the logic of the protectionist position, is the purity of interpretation.

Many analysts will have trouble with the logic of this argument even if they agree totally with the overall purpose of strengthening and furthering Canadian culture through protectionist means. Some will question whether citizenship is the right criterion for determining knowledge or insightfulness. Others will dispute whether one view of Canada is more "authentic" than another and whether, in a liberal society, it is the task of the writer or scholar to try to transmit a particular set of social or cultural values even if such a "correct perspective" could be agreed upon.

Nonetheless, the logic for protectionism of textbook publishing in Canada because of the alleged heavier focus on Canadian topics and authors has led to the practice of

providing subsidies to Canadian-owned publishing houses publishing Canadian authors and to discriminatory government procurement of books from such houses.[20] It is well therefore to submit at least the initial justification for these practices to further examination, namely that domestically owned publishers select a higher ratio of Canadian authors than foreign-owned publishers. For the moment, let us accept the supposed higher ratio as fact although there may even be some dispute about the reliability of the statistic.

A number of reasons come to mind for the alleged higher ratio, some supportive of the cultural argument, some opposed to it. First, one would like to think that Canadian publishing houses publish a higher ratio of Canadian authors because the Canadian houses are more diligent and open to a quest for Canadian authorship. They work harder, focus their search more, and therefore are rewarded with the higher ratio.

A second possible reason foreign-owned firms do not publish a higher number of Canadian authors is the preference to repackage for the Canadian market what they sell in the broader American market-place, at almost no additional editorial cost. Both the Canadian author and the concentration on Canadian subject matter would suffer from such a policy.

A third possibility is that Canadian publishing firms do not have the same access to the North American market-place as a whole through facilities to market abroad and the benefits of large production runs and thus tend to specialize in the market they know best, Canada. A higher ratio of Canadian to foreign authors is thus a natural outgrowth of this type of specialization.

A fourth reason for the higher ratio of Canadian authors is very simple: Canadian firms may consciously discriminate against foreign authors and in favor of Canadian authors. But for this explanation to carry much weight there must be an economic rationale. The economic rationale may be that if Canadian firms publish Canadian authors they receive subsidies not available to the foreign-owned houses thus eliminating much of the competitive risk normally associated with any form of publishing. If this last argument is the most valid explanation for the higher ratio of Canadian to foreign authors, it makes the whole rationale for the protection-of-culture-in-textbooks a tautology. Based on evidence that Canadian publishing houses publish a higher ratio of Canadian to foreign authors, they receive a government subsidy. But it is the government subsidy that is in reality responsible for why they publish a higher ratio of Canadian authors in the first place. In this last case the cultural logic of why textbooks receive special protection is totally bogus.

In this little case study of textbook publishing, like so many other areas in the cultural industries, much more careful thought and research ought to go into policy decision making before governments embark on the costly and difficult to reverse process of handing out subsidies and other forms of protection in the name of cultural enhancement.[21] Which of the above arguments are valid, and which are not, makes a great deal of difference to the policy process. If the resulting policies begin to impinge on

foreign investment and trading partners, the prudence contained in this assessment seems even more compelling.

But the hypothesis that increased trade itself is no threat to the Canadian cultural identity is strengthened beyond the observation that certain cultural areas are not and never will be impinged upon by trade negotiations or beyond the demonstration that some protectionist policies such as in textbook publishing may be ineffectual. In some areas current so-called cultural policies actually worsen the prospect for reinforcement of the Canadian cultural identity.[22]

For example, (1) restriction on repatriation of profits and royalties and (2) restriction of the sale of foreign-owned subsidiaries actually tend to keep some foreign investment in the cultural industries in Canada. If a foreign-owned publishing company is unable to repatriate profits it has no choice but to plow them back into the Canadian economy thereby substantially increasing its Canadian holdings over time. Instead of selling out, it continues to aggregate its presence in Canada. Likewise rather than face restrictions on the sale of its foreign subsidiary in Canada, a TV broadcasting company may simply increase the size of its already large presence to obtain an even more imposing market share. If the borders were more open, each of these firms might long ago have sold out to the highest bidder who might have been in actual practice a Canadian firm, a joint venture, or the firm of another foreign country.

In addition the protectionist course in the cultural industries like elsewhere has a number of deleterious effects not only on international trade but on the economy itself where the course is followed. Protectionism in the cultural industries tends to generate monopoly profits to a few owners of TV and radio companies and magazine and newspaper chains.[23] Consumers of cultural materials in Canada pay very high prices for what they buy and consequently they buy less, including less of the Canadian product, than they otherwise would. Finally, Canadian firms in recording, publishing, video, and broadcasting when treated like infant industries, remain infant industries, producing largely for the Canadian market without branching out into the North American market as a whole.[24] Since they are saved from competition, they fail to learn to compete internationally, thus denying Canadians the opportunity to benefit from the economies of scale that would make some of these firms world-class as well as more productive at home. Greater amounts of foreign trade combined with freer trade might actually witness a decline in foreign ownership in the cultural industries. More protectionism of the kind employed in the past may only serve to encapsulate the remaining foreign investment inside the Canadian market forever.

In short, greater amounts of foreign trade and a more open trading arrangement is not likely to impinge negatively upon the cultural industries in Canada and may in the case of a possible reduction of foreign investment actually strengthen the place of Canadian capital in these industries. Whether larger Canadian ownership and control will actually make the output of these industries more "Canadian" is perhaps doubtful as is the asserted further consequence that Canadian entertainment and communication will therefore benefit. But the argument that more trade will convey more foreign cultural influence at the least can be laid to rest. Cross-cultural trade has long since been

less of a source of foreign ideas and behaviour patterns than direct contacts and transmittal of information.[25] Hence the second hypothesis reads as follows.

Hypothesis 2 Greater trade with the United States assisted by bilateral talks is not likely to have a negative impact on the capacity of Canada to flourish in the fields of high culture, education, communication, or entertainment.

Hypothesis 0 Greater trade with the United States will undermine Canadian culture and the Canadian cultural industries.

My third hypothesis is that many Canadians, while they exaggerate perhaps the truth of the first hypothesis, just do not believe the truth of the second hypothesis. Because Canadian cultural nationalists passionately believe the first hypothesis and just as passionately reject the second, governments in Canada will continue to respond by passing legislation to "protect Canadian culture."[26] The more the United States protests, and the more American firms attempt to challenge such political efforts, the more Ottawa will find itself in a dilemma and will attempt to protect its electoral base by taking steps to appease the cultural nationalists.

At a second level of activity, the more Ottawa does for "Canadian culture" the more Quebec City will be expected to do for the purity and vitality of Quebec culture.[27] Fear of erosion of Francophone values and language usage as a byproduct of the effort to strengthen Canada-wide culture at the federal level drives Quebec premiers to seek ways to show Quebecers how resolved Quebec is to safeguard its own proud and distinctive culture through government incentive and protection. These efforts at the provincial level convince federal politicians that Quebec "nationalism" is again on the loose.

In political terms, if not culturally, the advantage of using the United States as a foil or a proxy is quite clear. If the United States did not already exist, it would have to be created. Worried about Canadian unity and cohesion, Ottawa in the past has from time to time sought to respond to a strand of Canadian opinion that the United States is the single largest threat to the survival of Canada.[28] The theme of the great external evil is one familiar in many cultural settings, notably in Iran today, for a very long time in China, and even in Northern Italy toward docile Austria. It is a useful political technique to unify otherwise fissiparous internal societal communities and groupings.

In Canada the image of the external threat as an internal unifying force has an additional dimension. For Quebec, the United States is a great asset in bargaining with Ottawa. The prospect of some form of collusion with Washington or closer Quebec-U.S. relations is always guaranteed to bring out the worst fears in an Ottawa politician, thus softening him up for further concessions, not necessarily, but possibly cultural, in favour of America's favourite province. While from time to time the United States protests at being dragged into internal Canadian quarrels, it is flattered nonetheless to be thought so relevant, especially at a time when its relevancy is being questioned elsewhere further abroad. So in its own way the United States out of hubris allows itself to become entangled in the great Canadian sport of cultural politics.

Since many Canadians are resolute in their belief that trade with the United States impinges on their cultural sovereignty, governments for some time have been busy erecting barriers and safeguards, subtly defended by the special interests who benefit most directly, designed to stave off the perceived foreign threat. Table 1 illustrates in comparative terms *vis-à-vis* the United States the restrictions in place to safeguard the cultural industries. Only in the case of local ownership restrictions for television and radio are there comparable forms of protection in both countries. Otherwise the edifice of restrictions in the cultural area in Canada is much broader and deeper, just as the level of foreign ownership and control in Canada is much higher and more broad-based. Regardless of whether trade will have any negative effect on Canadian culture, many Canadians think the effect will be negative and will thus prevail upon Ottawa to defend the edifice of restriction in the future.

A popular argument in defence of the exclusion of the cultural industries from the trade talks will be the attempted equation between protection for national security reasons and protection for reasons of cultural sovereignty.[29] Superficially an identity of concerns seems to exist here. The Americans have their national security exclusions; the Canadians have their exclusions based on concern for cultural security. Cultural security is more of a problem for Canada; national security is the principle preoccupation for the United States.

Apart from the not trivial difference that the United States is conceived as the source of cultural threat to Canada whereas Canada is not regarded by Americans as the source of the U.S. security dilemma, there are other deficiencies in the cultural/security comparison from the American viewpoint. First, U.S. "national security" is Canadian "national security" in large part, and Canadian national security is American national security. If that were not true then the meaning of NATO and NORAD escapes the understanding of foreign affairs held by most Americans. Canadian and American interests are by no means identical. But in the national security area interests have historically in the twentieth century at least been very close.

Second, Canada unlike other allies of the United States has traditionally benefited from the Defence Production Sharing Agreement which enables Canada to get inside American procurement rules in order to produce at home while selling abroad. Thus in economic terms Canada does not suffer the same exclusions in military production and sales felt by other allies.

Third, most commentators would observe, certain sensitive information is involved in defence production that is not involved in many other non-military areas. For reasons of intelligence safeguards, the rules regarding manufacture and sale must be different in the military supply area than in most areas of civilian production.

Despite the reality that national security output is different from other types of output, the national security label is a form of impediment on the free flow of trade and factors of production in a technical sense and may be abused. Where the national security argument is used to facilitate protectionism rather than a legitimate need, the United States ought to be challenged for its practices. A number of Canadians may, however, instead continue to equate national security with cultural security at least for purposes of

bargaining with the United States to defend restrictions in the cultural industries. It probably is an argument that if pressed too hard may unravel more irritations in the United States over such matters as burden-sharing than the argument is worth to the defence of cultural security.

Regardless of what argument Canada uses to plead for continued exclusion of the cultural industries from fuller international competition, Canada is likely to prevail because the United States recognizes the apparent volatility of opinion in Canada on this topic. But Canada is not likely to get a good hearing in Washington, inside the bilateral trade talks or outside, if the current set of trade and investment restrictions in the cultural area is extended in any of the following ways:[30]

1. If Canada chooses to transfer the strategy of the National Energy Program to the cultural industries, namely coerced sale so as to Canadianize a sector by use of discriminatory tax treatment or other additional derogations of national treatment, an outcry is likely to be heard in Washington that will not contribute to the muting of American protectionism. The NEP is very much still in the mind of American legislators, undoubtedly too much in their minds. To further sharpen their selective memory would be a disservice both to the Canadian and American national interests.

2. If firms with the bulk of their holdings in the cultural industry area begin to diversify broadly into other industrial areas while at the same time demanding and enjoying the same level of protectionism as in the past on the grounds of their inability to compete with foreign firms, Americans are likely to be much less sympathetic with the set of non-tariff barriers now in place to safeguard these economic interests. The sense will be that they are unfairly using their protected holdings to gain a foothold elsewhere in industry on the one hand and on the other that their revenue from non-culture industry-related earnings is more than sufficient to make them very significant commercial enterprises in the cultural field if they choose to make the proper investment. This same feeling is already evident in Canada in some other areas where protected earnings have, it is argued, led to overcharges to the Canadian consumer.

3. If Canada protects the cultural holdings of a firm at home while that firm expands substantially into the United States where its sales and income begin to outweigh its earnings in Canada, American firms are likely to begin to ask questions about the reciprocity of the conditions for trade and investment. Once a firm becomes international it probably must begin to live by trade and commercial rules that are more broadly open to scrutiny of all the governments under which it does business than when it enjoyed the shelter of only a single government. A number of Canadian firms already present to a significant extent on both sides of the border or about to enter the U.S. market significantly will appreciate the implications for their status as a Canadian "cultural" firm.

It does not really matter in political terms whether the second hypothesis is in reality correct or false. If Canadians believe the hypothesis to be false, and many do, namely the hypothesis that there is some sort of relationship between a free trade agreement and cultural erosion, Canadian governments will initiate programs, spending $75 million or so, as Ottawa did in the last budget, to augment and reinforce Canadian culture. Notwithstanding the above-mentioned qualifications, this third hypothesis maintains that many Canadians will press for special treatment in the cultural industries and that the Canadian government will respond by perpetuating most if not all of the customary restrictions on trade and investment in these areas.

Hypothesis 3 Canada will prevail in the attempt to perpetuate most non-tariff restrictions now in existence on behalf of the cultural industries.

Hypothesis 0 Canada will not prevail in the attempt to perpetuate most non-tariff restrictions now in existence on behalf of the cultural industries.

Conclusions

My conclusion from all of this is threefold. Canada has something of a cultural dilemma. It would be foolish and unrewarding for the United States to deny this fact. The matter of Canadian culture is important. It is important, or should be important to the United States in dealing with Canada, because Canadians feel it to be important and will act accordingly. The principle that Canada has a right to take steps to augment and strengthen its own culture ought to be accepted by the United States as understandable and legitimate.

But the second conclusion I draw is that there is a right way and wrong way to go about stimulating and preserving culture, either high culture or entertainment, either in textbook authorship or in artistic performance. The method is just as important and subject to critique as is the principle without qualification. Let me give examples of the significance for Canada-U.S. relations of the method chosen to augment culture.

A society has the right to establish rules for artistic performance, to determine whether a textbook is reflective of its traditions and values, and to set standards for the entertainment it provides its children.[31] This can be done within the community, at the provincial level, or at the federal level. Many scholars, performers, and artists will bitterly reject these guidelines as paternalistic, or worse, but the society in the interest of its own self-preservation has the right to establish the guidelines.

But among modern industrial countries, at least, a society ought not to protect its interpretation of cultural output by claiming that only a Canadian or American can perform a role adequately or write a book properly. Similarly, a society should not claim that only a Canadian firm or an American firm, because of its national identity, is able to produce the kind of cultural output that the society deserves. This is spurious reasoning.

It also flies in the face of investment norms and common sense. Only the final output can be judged for authenticity.

Cultural output should be judged on the basis of what is produced per se, not on the basis of the citizenship of the scholar, artist, or performer creating that cultural product. This is the ideal norm, and for the most part both governments live up to it.

I hesitate to think how much poorer both Canada and the United States would be culturally if either society had rejected foreigners as a source of cultural ideas in the twentieth century.[32] By ignoring these norms, a country will limit the quality of its cultural development and will make close trading partners irritable.

In sum, there is a difference between defending the principle of cultural sovereignty and defending the methods to nurture that sovereignty. Unless the United States accepts the principle of Canadian cultural sovereignty, and unless Canada recognizes that some methods of furthering that sovereignty are troublesome, this question of culture is going to cloud the bilateral negotiating agenda for a long time.

My third conclusion is that if hypothesis three is valid, that is, if Canada demands and receives exclusions for the cultural industries, Canada will have to weigh the opportunity costs in terms of bargaining.[33] Canada will be asked to give up something else in return for this exclusion. Faced with the reality of such a bargaining trade-off, some Canadian proponents of broad-based exclusions for the cultural industries may react as the leader of a provincial parliamentary delegation recently did in Washington: "Under those circumstances, maybe we in Canada do not have such a cultural problem!"

Table 1
A Comparison of Canadian and U.S. Cultural Trade Barriers

Obstacle	Country and Industry
Restrictions on repatriation of profits, royalties	Canada: Books
Local ownership restrictions	Canada: Books, television, radio, performing arts
	United States: television, radio
Personnel restrictions: governmental, union	Canada: Movies, performing arts
Discriminatory taxes on	Canada: Magazines, television, radio
Inadequate protection of intellectual property	Canada: Television
Government subsidies or tax breaks to local industries	Canada: Magazines; books; movies; records, cassettes, and VCRs; performing arts; visual arts
	United States: television, performing arts, visual arts
Government-owned (controlled) industries	Canada: Television, radio
Discriminatory licensing regulation	Canada: Television
Quantitative restrictions on import or distribution	Canada: Movies (Quebec), television, radio
Discriminatory government procurement policies	Canada: Books

Source: Steven Globerman and Aidan Vining, "Canadian Culture under Free Trade: Should Canadian-U.S. Trade Liberalization Extend to Culture?" *Canadian Business Review*, Summer 1986, p. 19.

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V.

Trade Policy in the United States: A Primer on Legislation and Administration

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1. Introduction

A vast assortment of protection is seemingly available for the asking to U.S. companies. The analogy with an ample Scandinavian smorgasbord seems appropriate. In reality, U.S. trade laws are very specific about what must be proven to get protection; and obtaining import relief or export assistance often proves more difficult than the American petitioner expects. A trade complaint, such as an anti-dumping petition, requires the deft hand of a skilled trade lawyer and ample supporting facts to succeed. Similarly, to amend the U.S. trade laws is no easy matter: industry associations often labour in Congressional vineyards for years before obtaining results.

The purpose of this paper is to provide a basic introduction to the legislative and administrative processes of U.S. trade policy. In this short piece, I do not purport to explore U.S. trade law and policy in depth. I touch only a few highlights. Serious analysis will be found in standard texts, for example, *International Trade and Investment* by John H. Barton and Bart S. Fisher (Little, Brown and Company, Boston and Toronto, 1986).

My comments are developed in three stages. First, I identify the different actors who influence trade law. Second, I survey one area of U.S. trade law, non-tariff barriers. Finally, I use the Canadian softwood lumber imports case to illustrate how the laws and actors have worked together in practice.

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* John Banks and Sabra Purtill, both graduate students at the School of Foreign Service, Georgetown University, assisted in writing this paper.

2. Many trade actors

A complicating characteristic of U.S. international trade policy is the number of actors involved. The players include public sector officials ranging from the president and the Congress to the independent International Trade Commission, the U.S. Trade Representative (USTR), and the International Trade Administration (ITA) of the Department of Commerce; and private sector actors such as individual companies and industry associations. The actors are not reading from a common script; instead each actor has his own interests to protect and promote, and diversity usually leads to conflict.

When the founding fathers divided authority among the three branches of the federal government, they assigned Congress responsibility for regulating foreign commerce, and they gave the president the task of conducting foreign policy. As a consequence, the legislative and executive branches of the federal government exercise overlapping control over trade policy. Most day-to-day actions however, do not directly involve either the president or Congress. Instead, designated agencies in the executive branch, or the independent International Trade Commission (ITC), carry out specific tasks mandated by congressional legislation.

When the stage moves from day-to-day measures to broad new initiatives, the congressional role becomes paramount. Congress can pass new legislation which overturns prior legislation and prior treaties, and Congress can define the scope of future trade agreements. Elected members of Congress are disposed to pay attention to their constituents. How closely a congressmen listens to his constituents on trade matters depends largely on the importance of the industry in the congressional district. Some congressmen, such as Senator Russell Long (D-La.), Senator John Danforth (R-Mo.), and Representative Sam Gibbons (D-Fla.), have carved out leadership roles on international economic issues, and those roles transcend the concerns of constituent politics.

The president plays several roles in the trade policy process. In the legislative arena, he can initiate new trade legislation, he can use his stock of political bargaining chips to push the Congress, and he can shape congressional drafting efforts with the well-timed threat of a veto. As chief diplomat, the president can resolve trade conflicts between the United States and a foreign country by suitably combining confrontation and negotiation. Finally, as head of the executive branch, the president arbitrates trade policy disputes between the various executive branch agencies.

Several executive branch agencies play major roles in the trade policy process. The USTR is the president's designee for trade policy formulation and negotiation. This small office (about 60 professionals) seeks to achieve consensus between the executive branch agencies on trade issues as they arise. Whenever external negotiations are required, the USTR acts as the presidential representative. But while the president gives the USTR its marching orders, the USTR must constantly stroke congressional concerns.

The ITC and the ITA of the Department of Commerce are the primary actors in evaluating trade complaints. For instance, in a countervailing duty case, the ITA determines whether or not a countervailing duty is justified and, if so, its level. The ITC determines whether imports have harmed the petitioning industry.

Other agencies involved in the trade process are the Department of Labour, which monitors and documents the effects of foreign imports on domestic employment; the Department of Agriculture, which largely formulates agricultural trade policy, and administer such legislation as the Meat Import Act; the Export-Import Bank which promotes exports by providing finance; and the Department of Defence which monitors high technology exports. The State Department and the Treasury Department both exercise an oversight role: the Treasury Department ensures that trade policy remains consistent with broader economic policy; the State Department ensures that trade policy does not disrupt the foreign policy process. These oversight functions are vestigal remains of an earlier era when State and Treasury formulated and administered the whole of trade policy for the executive branch.

In activating U.S. trade remedies or in changing U.S. trade laws, the private sector often sets the stage and starts the play. Sensing opportunities in foreign markets, or threatened by overseas competition, individual firms and entire industries will try to promote their exports, or protect themselves from imports. Often these efforts lead to litigation under existing laws or to lobbying for new laws.

The numerous private sector organizations that work to influence the government vary widely in size, subject concerns, and political clout. Some have a narrow industry focus, like the Antifriction Bearings Manufacturers Association and the Committee to Preserve American Color Television; other groups are concerned with particular issues, for example, with the taxation of export profits or the imposition of countervailing duties against natural resource subsidies. Some broad-based associations use trade questions as a tub-thumping way to attract notice and support. A saying in the American Textile Manufacturers Institute (ATMI) is that international trade generates 10 per cent of the industry's problems and 90 per cent of ATMI's dues.

Larger organizations keep a watching brief on the U.S. trade scene. The Business Roundtable, the U.S. Chamber of Commerce, the National Association of Manufacturers, and the U.S. Council for International Business, together with the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), examine nearly all major legislative proposals with a view to the international competitive position of the United States.

The sheer number of actors involved in the U.S. trade scene could fill a Cecil B. deMille epic. The crowded stage leads to jostling and conflict. The situation is much more complex than industry calling for protection and government defending free trade. Within the private sector some industries, such as financial service firms, support new trade talks; while certain regions, such as the Pacific Northwest, seek larger export credit programs to promote aircraft sales. In a recent convoluted episode, the Corn Growers Association pulled its punch against the Jenkins textile bill in consideration of a cash contribution by the Cotton Growers Association to help to fight the Canadian countervailing suit against corn imports.

Conflicts within the public sector are equally sharp. For example, the Treasury Department and the USTR may take quite different views over the merits of a government-sponsored semiconductor cartel. Big trade questions are ultimately resolved

by the president, and most presidents give high priority to foreign policy repercussions. Therefore, the White House generally resists protectionist measures or, as a fallback, accepts *ad hoc* solutions (such as informal steel quotas) which, to a large degree, accommodate the interests of foreign producers.

3. Many trade actions

Trade policy encompasses a large number of activities ranging from trade negotiations to import restrictions to export promotion. In this short survey, I will concentrate on one aspect: the major options available to private sector actors seeking import restrictions under existing U.S. international trade law.

Non-tariff U.S. trade actions can be grouped into roughly four categories: escape clause relief against "fair" but injurious trade; statutory frameworks for addressing "unfair" trade such as anti-dumping and countervailing duties; discretionary quantitative restrictions implemented by the president; and statutory quotas enacted by Congress. In almost all actions, complaints filed by domestic firms provide the impetus for government action.

Escape clause relief. Article XIX of the General Agreement on Tariffs and Trade (GATT) provides that a member country may request exemptions from its "bound" tariff rates when imported goods injure, or threaten to injure, a domestic industry. This "escape clause" was intended as the primary route for temporary protection by GATT members. In practice, it has been used for small and medium-sized trade cases, but not for large cases—such as textiles, agriculture, and steel. One drawback, from the standpoint of producer groups and government negotiators, is the transparency of escape clause proceedings. Another drawback (from the same vantage point) is that the state requesting an exemption should make tariff concessions on other articles in exchange for escape clause relief. A third drawback is that protection should be nondiscriminatory as among GATT members, which in practice means a multilateral tariff rather than a set of bilateral quota arrangements.

A fourth drawback (again seen from the producer standpoint) is that escape clause relief should be phased out within a reasonable period of time.

In the United States, petitions for escape clause relief are filed with the International Trade Commission. The ITC conducts an investigation to determine whether the industry requesting relief has been "seriously injured" or "threatened with serious injury" by an increase in the imports in question. If the ITC finds that injury does not exist, or is not caused by imports, the case is closed. On the other hand, if half of the commissioners (there are six) recommend relief, the case proceeds to the president. The president decides whether or not relief is justified; and, if so, how it is to be provided—for example, by increased tariffs, or through bilateral orderly marketing arrangements *(OMAs)*.

It is worth noting that escape clause relief approved by the ITC is often denied by the president. Some 53 escape clause relief petitions were filed between 1975 and 1984. Of these 53, more than half (31) were approved by the ITC Commissioners, but only a quarter (13) were approved by the president.

Protection against "unfair" trade: anti-dumping and countervailing duties. Starting with the countervailing duty statute of 1890 and the anti-dumping duty law of 1916, the United States has stocked an ever-expanding armoury of weapons against "unfair trade." While the armoury today is formidable to behold, only about 1 per cent of U.S. imports are subject to unfair trade investigations annually. Penalty duties are assessed on a far smaller fraction of trade.

At one time, the imposition of anti-dumping duties and countervailing duties was a discretionary act of the Treasury Department. In recent years, administration of the statute has been confided to the Commerce Department, and discretion has largely been taken out of penalty duty investigations. Instead, the investigations are subject to tight timetables, open procedures, and judicial review.

U.S. anti-dumping legislation provides for the imposition of anti-dumping duties on foreign imports that are sold at "less than fair value" when those sales injure the domestic industry. Essentially, the anti-dumping statute protects U.S. firms against injurious price discrimination by foreign firms. Whatever the wisdom of such laws (and they are questioned by many economists), most industrial countries have anti-dumping statutes.

In the U.S. law, the benchmark of "fair value" is normally the home market price of the product, but sometimes a constructed value is used. An investigation is usually initiated by a petition from private industry. The International Trade Administration (ITA) investigates the existence of dumping, while the International Trade Commission (ITC) investigates whether the domestic industry has been injured. This division of bureaucratic power gives some tasks to the executive branch and other tasks to an agency which is independent of case-by-case presidential control.

Within 45 days after the petition is filed, the ITC issues its preliminary findings on domestic injury. If that finding is negative, the investigation stops; if it is affirmative, the ITA proceeds to determine whether foreign products are in fact being dumped on the U.S. market.

Within 160 days after the filing of the petition, ITA publishes its preliminary determination. After additional information is received and sifted, ITA issues its final determination. If the ITA finding is affirmative, the ITC then makes a final determination on injury. If the ITC determination is also affirmative, an anti-dumping duty order is issued and a penalty duty, equal to the margin of dumping, is placed on the dumped imports.

Whereas the anti-dumping duty law was designed to answer the supposed evils of price discrimination by foreign private firms, the countervailing duty law was designed to answer the supposed evils of subsidization by foreign governments. The United States

has two different types of countervailing duty investigations: one for countries that have signed the GATT Subsidy Code, and another for non-signatory countries. If the case is initiated against a signatory country, the evidence developed in the investigation must show both the existence of a subsidy and injury to the domestic industry. If the country is not a code signatory, the injury test does not apply.

The International Trade Commission conducts a preliminary investigation on the domestic injury question. If the determination is negative, the petition is rejected. Otherwise, within 85 days after the filing of the petition, ITA must issue its preliminary determination as to the existence of a subsidy. The preliminary determination has this consequence: if affirmative, subsequent imports are subject to countervailing duties (a similar consequence attaches to an affirmative preliminary determination of dumping). Regardless of the preliminary determination, ITA then initiates a more detailed analysis, involving questionnaires sent to the foreign government and foreign companies.

Within 75 days after the publication of the preliminary determination, ITA issues its final determination. If the ITA determination is affirmative, the ITC then makes a final determination on the injury question. At the end of the ITA and ITC process, either party can appeal to the Court of International Trade. Judicial review is also available in anti-dumping investigations and most other unfair trade actions.

Discretionary quantitative restrictions. While the president no longer has discretion to control investigations concerning escape clause relief, anti-dumping duties or countervailing duties, he still retains considerable influence over the nature of relief granted. Quantitative restrictions imposed by the president are one alternative to implementing either escape clause tariffs or penalty duties. In these and other instances when quantitative restrictions are desired, the USTR will be instructed to negotiate an arrangement with the exporting countries. These agreements, known as voluntary restraint agreements (VRAs), voluntary export restraints (VER), or orderly market arrangements (OMAs), are primarily enforced by the exporting countries themselves. Some examples are the Multifibre Agreement (MFA), President Reagan's steel VRA, and recent Japanese restraints on semiconductor exports.

Discretionary quantitative restrictions have become the executive branch's preferred means of granting import relief, particularly for large troubled industries. Politically, this approach allows the president to help a threatened industry, while sidestepping higher duties or legislative action that would antagonize exporting countries. In addition, these arrangements are flexible and can be altered or allowed to expire, at presidential discretion, when market conditions and political circumstances change.

Statutory quotas. Another vehicle for import relief is the statutory quota. If a powerful industry has not secured relief through normal means, it may yet persuade Congress to pass legislation effectively limiting imports. Such quotas represent the most decisive exercise of congressional trade power; and typically the quotas are neither flexible nor temporary. Examples of such quotas are the Jones Act (enacted in 1920), the Meat Act (enacted in 1964), and the Magnuson Fisheries Act (enacted in 1976). The Jenkins

Amendment, which would have restricted textile and apparel imports, was the most recent run at statutory quotas. The amendment was passed by Congress, but vetoed by President Reagan.

3. Case study: Canadian softwood lumber

The intricacies of U.S. trade law are illustrated by the case of Canadian softwood lumber exports to the United States. On October 7, 1982, the Coalition for Fair Canadian Lumber Imports, an *ad hoc* lumber industry organization, filed a countervailing duty petition. The U.S. lumber producers claimed that the Canadian government subsidized lumber production by selling lumber "stumpage" rights to Canadian forests at bargain prices. Some studies claimed a subsidy of 27-40 per cent. According to the allegation, this practice enabled the Canadian industry to enlarge its exports to the United States.

Because Canada is a signatory to the GATT Subsidies Code, the U.S. lumber industry had to satisfy both the injury and subsidy requirements. The first step in the investigation was for the ITC to issue a preliminary determination of injury. Applying the low threshold required in a preliminary determination, the ITC decided, on November 22, 1982, that there was evidence of harm to the U.S. industry. In addition, the ITC stated that "trends indicate a likelihood of continued influence by Canadian products on the U.S. market."

In the meantime, the ITA decided that, because the petition involved "extraordinarily complicated" questions, more time and information were needed to conduct an adequate investigation. With a time extension of 65 days, the ITA requested additional information from the Canadian government. On March 11, 1983, the ITA issued a preliminary negative determination—finding no indication that Canadian lumber was subsidized. After reviewing additional briefs submitted by the petitioners and respondents and more information provided by the Canadian government, a final negative determination was made on May 31, 1983, eight months after the petition was filed. The U.S. lumber industry was denied relief.

Contrary to Canadian expectations of American protectionism, and despite the ITC's preliminary finding of injury, the U.S. lumber industry did not succeed in obtaining a countervailing duty order. Instead, the ITA accepted the argument that Canadian removal rights were "generally available"—analogous to ports, roads, or schools—and therefore did not constitute a countervailable subsidy.

Following Commerce's final negative determination, the U.S. lumber industry was faced with several options. One option—preferred by Canada but not by the U.S. industry—was to accept the determination and to find some means of competing with Canadian lumber that did not involve further trade litigation. A second option was to appeal the ITA decision to the U.S. Court of International Trade. This is often done. For example, in the case of carbon black imports from Mexico, the court reversed the ITA's exposition of the "generally available" doctrine. A third option was to refile a petition at a

later date. In fact, a different *ad hoc* lumber group did just that on May 19, 1983. The fourth option was to try to change U.S. trade law so that the Canadian stumpage practices would be defined as a countervailable subsidy. This option was also pursued by the U.S. lumber industry.

At the same time that the Canadian softwood lumber petition was under review in the ITA and the ITC, Congress began toying with the idea of "reforming" U.S. anti-dumping and countervailing duty legislation. In March and April of 1983, hearings were conducted by the trade subcommittee of the House Committee on Ways and Means. The chairman of the committee, Representative Gibbons, was especially interested in a trade reform bill and he was anxious to gauge the reaction from American industry. One subject raised by U.S. firms was the exemption of certain foreign incentive practices from the scope of U.S. countervailing duty law. Natural resource subsidies were often cited. Such complaints attracted Gibbons' personal attention.

On October 20, 1983, Gibbons held the first of several hearings on natural resource subsidies. Legislation was proposed to expand the countervailing duty law to encompass products exported to the United States that received a significant benefit from the bargain sale of government owned natural resources. If the domestic sale price of a resource was (1) less than its export price, or (2) less than the world market price, or (3) less than the price generally available for U.S. producers, a countervailing duty was proposed on products embodying the resource. This proposal would have benefited many industries—such as petroleum refiners, petrochemical producers, fertilizer manufacturers and lumber companies—that were previously unable to secure import relief under the countervailing duty law as interpreted by the ITA.

The natural resources proposal was included in H.R. 4784, the Trade Remedies Reform Act. This bill was later passed by the House of Representatives, but a sister trade bill passed by the Senate did not include the natural resources subsidy provision. Further, the natural resource provision was opposed by the Reagan administration. It was axed in the joint House-Senate conference committee which produced the Trade and Tariff Act of 1984, much to the disappointment of affected industries and their lobbyists.

But the affected industries did not allow the natural resource subsidies issue to die. In the next session of Congress, Gibbons held another set of hearings which resulted in H.R. 2451, known as the Gibbons Amendment. The Gibbons Amendment was virtually identical to the previous bill, except that it specifically included the lumber industry by adding a provision that covered "removal rights" for lumber.

Industry support for the Gibbons Amendment came from U.S. manufacturers of similar products and their unions. But some industry interests opposed the Gibbons Amendment. These interests represented purchasers of the products, such as gasoline marketers, home builders, farmers, and lumber retailers. Some of the affected industries formed *ad hoc* organizations to combine their lobbying efforts—the Independent Refiners Coalition, the Committee to Protect America's Trade, and the Independent Gas Marketers' Council.

Despite this opposition, the Gibbons Amendment was eventually passed by the House and was included in the House trade reform bill. But it seems unlikely that the Senate will pass major trade reform legislation in 1986. Thus, congressional disposition of the natural resource subsidy question, like many other trade issues, will await the Trade Act of 1987.

While Congress was working on new legislation, the U.S. lumber industry did not forget about other trade relief options. In late 1985 and early 1986, the Reagan administration sought Senate finance committee approval for "fast track" negotiating authority for a U.S.-Canada Free Trade Agreement. The chairman of the finance committee, Senator Robert Packwood (R-Oreg.), represents a major timber producing state. In February 1986, Packwood advised the administration that fast-track authority for the trade talks would depend on resolution of the lumber dispute.

This ultimatum galvanized the Reagan administration. The concerns of the U.S. lumber industry suddenly became the concerns of the administration. In April 1986, the USTR told the Canadian negotiating team that, unless the lumber dispute was resolved, the United States would take unilateral action against Canadian lumber imports.

The Canadian response was unequivocal. Prime Minister Brian Mulroney declared that, unless fast-track authority was granted by the Senate finance committee, Canada would withdraw its request for bilateral trade negotiations. This response left the administration and the finance committee scrambling to reach an accommodation.

At the eleventh hour, the Senate finance committee gave the Reagan administration fast-track authority, but not before extracting concessions. Almost immediately after receiving the good news, President Reagan told Packwood that the United States would invoke its law against Canadian lumber subsidies if bilateral negotiations did not resolve the dispute.

The Canadians suggested a high-level negotiating team to resolve the dispute through bilateral negotiations. In order to give the Reagan administration and the U.S. lumber industry time to evaluate the proposal, the administration asked the Coalition for Fair Lumber Imports to delay submission of its new countervailing duty petition.

Both administration and industry reactions to the Canadian proposal were negative. Instead of offering a definite proposal to resolve the long-standing controversy, the Canadians suggested another round of negotiations. This did not satisfy the lumber industry and, on May 19, 1986, the petition was refiled, but this time with administration support. In fact, the ITA even indicated that it might rethink its definition of what constitutes a natural resource subsidy, in light of the carbon black case, where the ITA exposition of the "generally available" doctrine was reversed by the Court of International Trade.

Not coincidentally, President Reagan placed a 35 per cent tariff on Canadian shakes and shingles in response to an earlier escape clause petition that was approved by the ITC. The message to Canada was clear—the United States wanted action on lumber.

The Canadians did not take all this quietly. Tariff concessions were withdrawn on certain products. The government suspended a planned announcement on free-trade arrangements for the pharmaceutical industry. Canada also publicly proclaimed before the GATT Council in Geneva that the United States was intentionally harassing Canadian industry and requested a formal GATT hearing. In addition, Canadian negotiators walked out of bilateral negotiations on the lumber dispute, claiming that they could not negotiate with a sword handing over their heads.

Facing the impending ITA preliminary decision on October 9, 1986, Canadian Trade Minister Pat Carney announced, in a meeting with U.S. Secretary of Commerce Malcolm Baldridge on September 9, 1986, that the provincial government of British Columbia was launching its own investigation of stumpage fees. Since British Columbia accounts for two thirds of Canadian lumber sales to the United States, this was seen as an indication of Canadian willingness to negotiate. The Carney-Baldridge meeting raised hopes that the dispute could be settled through government-to-government talks.

The lumber industry, however, matched the Canadian announcement by filing a new brief on September 9, increasing its estimate of Canadian subsidies. The new petition alleged 32 per cent subsidies, and was more focused geographically and industrially. It left out paper pulp products in eastern Canada and concentrated on western Canadian lumber and a new stumpage practice known as "sawtooth stumpage."

In September, the Senate finance committee came to its own impasse over the natural resource issue. One idea considered was to make sales of government-owned natural resources actionable whenever the terms are inconsistent with commercial practices. This idea was immediately attacked by a coalition of lumber users, the Coalition to Stop Unfair Wood Tariffs. This group told the Senate finance committee that the proposed language would invite retaliation and threaten the U.S. housing industry and U.S. jobs.

On September 30, the Canadian government offered to place the equivalent of a 10 per cent duty on its softwood lumber through increased stumpage fees in some provinces and export surcharges in others. The proposal was contingent on U.S. industry dropping the countervailing duty petition and withdrawing its support for new natural resource legislation in Congress. The offer, worth some $350 million, was significantly below the 32 per cent duty sought by the U.S. lumber industry.

At about the same time, Representative Ron Wyden (D-Oreg.) proposed a common pricing scheme to settle the dispute. The Canadians vociferously rejected this idea, proclaiming it was really a ploy to impose U.S. prices on the Canadian industry and suggesting it would abuse Canadian sovereignty.

The ITA missed the October 9 deadline for issuing a preliminary decision, apparently in hopes that some negotiated settlement could be arranged. Technically the delay is illegal, since the time schedule is set by law, but so long as a party to the proceedings chooses not to sue, plurilateral negotiations between the U.S. government (ITA), the Canadian federal government, the British Columbia provincial government, and the U.S. lumber industry can go forward.

4. Conclusion

The lumber dispute graphically illustrates the nature of the U.S. trade policy and legislation. The overall impression is complexity and confusion. By comparison, the Canadian approach seems straightforward: decisions are essentially taken by two actors, the Canadian federal and provincial governments.

What lessons can be drawn from these differences? The principal protagonists in this dispute, the U.S. lumber industry and the Canadian federal government, view the stage setting very differently. The U.S. lumber industry benefits from the existence of multiple channels for voicing complaints. The industry's impact can be felt in Congress, the USTR, the Department of Commerce, the Senate finance committee and ultimately in the White House.

Where the U.S. lumber industry sees opportunity, the Canadian government sees chaos. Canadian energies and bargaining chips are dissipated between the Senate finance committee, the Commerce Department, the White House, and the U.S. industry itself.

Canada would like to deal with a more centralized U.S. system, not only on lumber questions, but also on a wide range of trade disputes. Ideally, from the Canadian standpoint, trade authority in the United States would be concentrated in the USTR, reporting to the White House. This would permit decisive government-to-government talks, and encourage strong personal contacts between the negotiators.

This perspective is not, however, shared by powerful interests within the United States. Domestic industries are wary of centralizing the trade policy apparatus and granting discretionary power to the executive branch. They fear that the concerns of statecraft would come to dominate the concerns of commerce. In the lumber dispute, for example, the industry fears that its complaint might be placed on the back burner in order to improve the atmosphere for larger free trade talks.

What is the likely outcome of this conflict of styles? Possibly the free trade talks will give rise to a Canada-U.S. Commission designed to monitor and moderate future trade disputes. The commission, for example, might have legal standing to appear as an interested party in proceedings before the ITA, the ITC, and analogous Canadian bodies. But it seems overambitious to suppose that the trade powers that are now dispersed throughout the U.S. government will be centralized in the context of a trade agreement; or that judicialized U.S. trade proceedings will be replaced by the resurrection of a discretionary approach.

VI.

American Military Spending: Impacts on Industrial Structure, Regional Development and Trade with Canada

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Introduction

The U.S. commitment to a strong national defence has had a profound effect on the nation's industrial structure and regional development patterns. While these changes have been in the making throughout the postwar period, they have become more apparent, and perhaps have accelerated, in the 1980s. This paper documents the general size and composition of the military build-up. It details the industrial sectors, chiefly in the high-tech area, which have benefited from the build-up, and speculates on the reasons why the more mature non-military producers' goods and consumer durables sectors have lost ground in consequence. The marked shifts in the regional distribution of production are also documented and attributed to the unique priorities of defence-oriented manufacturers.

For Canada, with a manufacturing economy quite similar to the midwestern industrial complex in the United States, the dividends from the U.S. defence build-up do not appear to be positive. For reasons similar to those that plague the metals/machinery/transportation equipment industries in the latter, plus an explicitly Buy America policy in force at the Pentagon, Canadian manufacturers are not well-positioned to participate in the largesse of the U.S. defence budget. An analysis of data for 1981-1985 reveals that Canadian exports in non-defence-related industries like autos and office machine parts increased more rapidly than those in the heavily defence-dependent industries, like aerospace and telecommunications. Nor were these or other defence-related industries able to appreciably increase their market share of growing U.S. imports. The results cast doubt on the prospect that current plans for trade liberalization will boost U.S. demand for defence-oriented exports from Canada.

I. The U.S. Military Build-Up

It is widely believed that the United States, unlike most of its industrialized counterparts, does not have an industrial policy. Many critics point to this as a primary cause of relatively low productivity gains, a deteriorating trade balance, and widespread plant closings in recent years. Alternatively, one can argue that the military budget has become a *de facto* industrial policy, and that the poor performance of the economy is due to the efficiencies and distortions introduced by reliance on military-led investment and innovation.

Industrial policy is generally characterized by its inclusion of most or all of the following features. It targets specific sectors in the economy which are believed to possess long-term potential in promoting growth in employment and output. It provides substantial research and development funding to firms in those sectors. It offers large-scale incentives for technological innovation and funds for major investments on favourable terms. The government acts as a large and dependable customer through special procurement arrangements. It may offer trade promotion and/or protection as well. Industrial policies generally include adjustment assistance for displaced workers and communities, including retraining of personnel and conversion of idled facilities.

In the United States, military spending functions in all of these ways without explicitly being labelled industrial policy. Through research overheads on major prime contracts, and through special programs like the Defence Advanced Research Projects Agency (DARPA), it channels substantial resources to a rather small set of large, heavily defence-dependent firms in high-tech industries like aircraft and missiles, communications equipment, and electronics. It has provided a protected market for their products by acting as the single largest buyer in crucial early commercialization stages and by practising a Buy America policy. It has funded pioneering efforts to adapt numerically-controlled machine tools, computer-aided design and computer-aided manufacturing (CAD/CAM) systems and other automating technologies to the production of military hardware. It has built and leased or sold plants to defence contractors at bargain rates. Through the Pentagon's Office of Economic Adjustment, it helps communities to redevelop facilities and retrain workers following base or plant shutdowns. It offers lifetime job and income security to its personnel, including retraining services for retired officers.

The importance of this *de facto* industrial policy has been increasing over the postwar period, especially in the research area. Up to World War II, the federal government accounted for only about 15 per cent of research and development funding in the U.S. By the 1960s, its share exceeded 60 per cent; it has not decreased since.[1] Furthermore, the military share of this research budget has been growing at the expense of the civilian share. As recently as 1980, military research and development (R&D) consumed just over 50 per cent of the federal research outlays of US $30 billion. By 1985, it is estimated to have jumped to over 70 per cent of an enlarged US $50 billion.[2] Thus, the concentration research resources in the United States has increasingly shifted from private companies to the federal budget, and within it, from non-military to military projects.

In contrast to this secular growth trend in military-related research, military procurement has fluctuated with fashions in national politics. In 1955, federal military spending consumed about 11 per cent of the gross national product (GNP). By 1976, it had fallen to 5.5 per cent. By 1985, it had risen again to 6.5 per cent, driven by a 51 per cent increase in the overall military budget since 1980. The military as an industrial market has thus become increasingly important in the 1980s. While the build-up began under Carter, in the late 1970s, it has accelerated under the Reagan administration. The Pentagon's share of the federal budget rose from 23 per cent in 1980 to 27 per cent in 1985.

Recent budget increases have dramatically shifted priorities toward military capital investment (from 36 per cent in 1980 to 47 per cent in 1985) and away from the more traditional categories like base operating expenses, pay and benefits. Spending on weapons procurement has doubled, while spending on weapons research has grown by 80 per cent and on bases and facilities expansion by 95 per cent. And while the share of the budget spent on nuclear weapons has risen from 7 to 10 per cent, the lion's share of the budget increase has gone for hardware (weapons, weapons research and bases) for conventional forces. In 1985, US $213 billion was spent on the latter, chiefly for purchases of fighter planes, bombers, tanks, attack submarines, surface ships, helicopters and air-defence missiles.

The macroeconomic impact of the Pentagon budget, slated at US $312 billion in the 1987 budget and at US $2 trillion for the next five years,[3] is enhanced by the parallel growth in arms sales abroad. Throughout the postwar period, arms exports have continually grown as a component of our trade balance. The aerospace industry alone has been responsible for the largest U.S. trade surpluses in the postwar period. Weaponry produced in the U.S. now accounts for about 45 per cent of total world arms transfers, compared with 20 per cent in 1970. As of the early 1980s, some 840,000 U.S. jobs depended on foreign military sales.[4]

Arms sales have accelerated during the Reagan administration. Total exports of military-type goods rose from US $10.2 billion in 1980 to US $24.4 billion in 1984.[5] The Reagan administration has aggressively encouraged the expansion of arms sales abroad. Unlike Carter before him, Reagan facilitates the sale of first generation military technology to other countries. His administration has furthermore permitted U.S. corporations to use their research overheads to innovate for special military situations in the Third World, an activity Carter prohibited.[6]

The stimulus for key high-tech industries embedded in the military budget are not purely accidental, a byproduct of strategic decisions. The current administration's Strategic Defence Initiative (SDI) includes language that explicitly sets forth the dual goals of "national security and economic strength." The DARPA portion for strategic computing and artificial intelligence, funded at US $600 million for five years, contains a commitment to industrial development, including the intent to stimulate new computer concepts, encourage industrial funding, generate new computer-based applications, and pioneer new techniques in software development and methodology. Commercial concerns have thus been introduced deep into the very structure of military research programs, as a means of both justifying the enormous escalation in public research commitments and accelerating the transfer of military-supported innovations into commercial uses. The

military budget, in effect, has been assigned the task of being the nation's leading economic innovator.

II. The Industrial Restructuring Consequences

The macroeconomic consequences of military spending are difficult to document with precision. Some critics argue it is less efficient at stimulating the economy than social spending. Others argue the opposite. Research can be found to support either contention. But it is clear that military outlays do create jobs and that the Reagan build-up may be behind the modest "recovery" since 1983. However, the aggregate figures obscure an industrial restructuring which has been quite disruptive, imposing severe adjustment costs on industries, individuals and communities.

Most industrial policy debates stress the prosperity of manufacturing as the key to overall economic viability. This prescription is derived from economic base theory. The argument is that most sectors in an economy are secondary or tertiary, that is, their sales depend on the dynamism of a number of "basic" sectors whose output is largely exported. Previously, this theory was applied mainly to regional resource-based economies. But as the U.S. is increasingly integrated into a world market, the model is now more applicable to the economy at the national level than was true in the past. The continued sluggishness of the economy in the early 1980s, despite the Reagan tax cut, was in part a result of enormous shifts of consumer spending toward imports, which have expanded dramatically, especially with the escalation in the value of the dollar. The tax rebates leaked out of the economy at an unanticipated rate.

Military spending has rather nice built-in features which militate against this leakage. For strategic reasons, the Department of Defence (DoD) refuses to let more than a certain percentage of the components of its purchases be produced abroad. And when an imported product threatens to become too critical, the Pentagon requires U.S. contractors to build their own domestic plants. This occurred recently, for instance, in the "precursor" carbon fibres area, where the air force directed American Cyanamid, Celanese and Hercules to build their own plants for this important aerospace material input.[7] Thus our Department of Defence practises a Buy America policy at the same time that the Commerce and Treasury Departments espouse free trade.

Military procurement outlays, then, do create a new surge in investment activity that will ripple through the rest of the economy. This impact may affect manufacturing more directly than almost any other form of federal government macroeconomic policy. The most heavily defence-dependent sectors are almost entirely found within manufacturing. Of those sectors with more than 10 per cent of their output dedicated directly or indirectly to Department of Defence, all are manufacturing sectors, with the exception of military construction. Transportation and mining sectors are the only other immediate beneficiaries of defence spending.[8] These figures confirm an earlier government study which concluded that 66 per cent of all private employment

attributable to DoD spending (direct and indirect jobs but not induced jobs) occurred in manufacturing sectors.[9]

The increasingly sophisticated character of military hardware, and the fact that big ticket items are so expensive that many fewer units of them are purchased annually than in previous generations of weaponry, means that the industries stimulated by the military build-up are a quite different set than in the past. Where military spending was once considered to be "good" for steel, heavy machinery, and construction, nowadays its chief beneficiaries are the high-tech industries.[10]

The major defence industrial sectors are shown in Table 1. The prime contract sectors, like missiles, ordnance, aircraft and tanks, are understandably heavily dependent upon the Department of Defence for their market. They are also chiefly high tech in nature. Whether measured by the predominance of engineers and scientists in their workforce, or by the percentage of sales spent on research and development, missiles and aircraft top the list of high-tech industries in the United States.[11]

Less well understood is the degree to which major suppliers to the prime contractors are themselves simultaneously high tech and defence-dependent. The single largest high tech sector in the United States, communications equipment, which employs more than 425,000 people, is also heavily DoD-dependent. In 1979, 45 per cent of its output went directly or indirectly into Pentagon projects; by 1987, this military share will rise to 63 per cent (see Table 1). Industries like semiconductors and computers, not often considered military-oriented, will benefit disproportionately from the current build-up. Indeed, military-oriented output growth in computers tops that of all the other sectors in Table 1, up 141 per cent from 1982 to 1987. The build-up will reverse a 20-year tendency for commercial demand to outpace military output growth in the electronics and computing industries.

In contrast, the share of output in the heavy machinery and metals industries that is devoted either directly or indirectly to DoD outlays is small. In none of these categories, listed in Table 1, will DoD-related output exceed 12 per cent by 1987, despite hefty increases associated with the current build-up (Table 1). In steel, for instance, military demand accounted for only 4.5 per cent of sales in 1979 and even with the Reagan build-up, will reach only 6.7 per cent by 1987. Similarly, only about 7.5 per cent of total machine tool output in 1987 will be devoted to military purposes, up from around 5 per cent in 1979. These are industries whose viability is much more closely tied to the consumer economy and public investments in infrastructure, housing, mass transit and urban development. Particularly key for these industries is the general level of industrial investment, which has been conspicuously low in the early 1980s.

Why is there so little steel and machinery in contemporary military production? The answer lies in the fact that the bulk of expenditure for modern weaponry goes for highly skilled technicians and engineering personnel who hand-craft, assemble and test components for the complicated guidance and cybernetics systems that operate missiles, battleships, submarines, aircraft and tanks, and spacecraft. In contrast, the value of the

aluminum or steel in the shell is minuscule. Nor is much machinery used in production and assembly.

Take, for instance, communications satellites. In Hughes Aircraft's satellite facility in El Segundo, next door to the Los Angeles airport, some 8,000 employees produce approximately five satellites a year, some for strictly military purposes. Of those employees, all housed in one high-rise complex, only 300 work on the "shop floor." The latter consists of a modest, high-ceilinged set of bays in which small groups of between three and five technicians move around stationary satellites-in-progress. The only machines, other than hand tools, in the plant are a couple of multi-storey special chambers, into which completed satellites are introduced for testing under simulated conditions of space. These "machines" were tailor-made for the Hughes facility. The 7,700 other divisional employees are engaged in testing, research and development.

The non-military manufacturing sectors have also been eclipsed by the priority given in publicly-funded research and development to defence needs. Talent, especially in the engineering fields, has been drawn toward careers in the sciences critical to the defence effort—aeronautical and electrical engineering in particular—at the expense of industrial engineering. Ironically, this has placed American manufacturers in a relatively weak position to capitalize on the inventions emanating from the defence industrial complex. In the past 15 years, the Japanese and Europeans have successfully commercialized a number of important innovations, penetrating deeply into the U.S. domestic market for machine tools, electronics and communications equipment. In other words, the relatively poor performance of traditionally strong industrial sectors is due to constraints placed on the supply side through defence-led diversion of resources as well as to adverse shifts in demand for their output from the same quarter.

The shifts from the more traditional machinery and metalworking sectors of the U.S. economy toward the high tech sectors have begun to show up in the aggregate statistics. Output of both consumer goods and business equipment was virtually flat throughout 1985, while production of military and space goods grew steadily at 11 per cent. This divergence has been exacerbated by the changing composition of international trade (Table 2). Net exports of non-military capital goods fell from US $42 billion in 1980 to US $12 billion in 1984. Over the same period, net exports of military type goods tripled, from US $5.6 billion to US $16.7 billion.[12] The contrast between the two sectors is quite striking. A doubling of imports was almost singlehandedly responsible for the deterioration in the trade balance in the former, while a 140 per cent increase in arms exports accounted for the lion's share of the positive shift in the latter.

III. The Regional Consequences

The growth of defence-oriented manufacturing has been a powerful determinant of differential regional growth patterns in the postwar period. The major defence-related job growth has taken place on the "defence perimeter", an area stretching from the Boston area south through Connecticut, Long Island to Newport News, Huntsville, Alabama and

Melbourne, Florida, across the gulf states to Dallas and Houston, and encompassing much of the intermountain west as well as the Pacific Coast. Metropolitan areas like Anaheim (next to Los Angeles), Worcester (next to Boston), Dallas, Houston, and Lakeland (Florida) were among the top job gainers.[13]

Regionally, the Pacific tops the list of military expenditures per capita (Table 3). The only other regions that show a greater than national average share are the Mountain states, New England, and the South Atlantic region, in that order. Among the beneficiaries of military outlays, New England and the Pacific states rank extraordinarily high in procurement outlays, while the Mountain and South Atlantic states receive a disproportionate share in the form of military base personnel and pay. However, the South Atlantic region is the single largest recipient, share wise, of research and development expenditures. Remarkably, none of the four interior regions, the "Centrals," came within 90 per cent of the national average of military receipts.[14]

When measured a different way, by shares of manufacturing shipments directed toward the military, the rankings are similar. Certain states within the regions account for the bulk of military shipments, even when normalized for different sized production complexes. In the west, California, Arizona and Utah all rank within the top five of defence shipment location quotients, meaning that their manufacturing sectors depend heavily on the military (Table 4). Oregon and Idaho, on the other hand, have almost no military-related manufacturing. Similarly, the South Atlantic, Florida, Maryland, and Virginia are the big winners, while the Carolinas and West Virginia rank near the bottom. The state figures for manufacturing shipments support the defence perimeter metaphor. With the exception of Missouri and Kansas, no other non-coastal state between the Appalachians and the Rockies ranks in the top 15.

The bottom 15 states are predominantly interior states, and include some of the more significant manufacturers like Wisconsin and Michigan. The magnitudes of the differences are quite striking. While California ships out military material at a rate in excess of 150 per cent of the national average, for manufacturing, states like West Virginia and Arkansas are more than 90 per cent below that average. This disparity has intensified under the Reagan building up. From 1977 to 1983, the states of Massachusetts, Texas and California, all large to begin with, increased their shares of defence purchases at the expense of most other states.[15]

The broad trend, then, is the rebuilding of industrial capacity in relatively virgin locations, drawn heavily by defence spending priorities. This pattern is occurring because defence-oriented firms face quite different locational determinants than do conventional manufacturers. The latter have traditionally chosen least cost locations between major resources sites and major consumer markets, depending upon the transportation cost calculus. But military-related producers are relatively footloose with respect to both resources and markets. Raw materials form a tiny fraction of total costs for weapons system producers, and the location of the client (Washington, D.C.) is unimportant, since the produce itself is mobile and its destination often dispersed, secret, and/or changeable.[16]

What does matter to defence-related manufacturers is access. They need access to the type of labour central to innovative product development. They need access to other firms in the same business and military bases or launch sites where their equipment will be tested. Military-related plants do tend to agglomerate, as most innovative, youthful sectors do. But these agglomerations are somewhat surprisingly not to be found along side older centres of innovation in basic manufacturing but in entirely new or revitalized centres typified by Silicon Valley; Orange County; Huntsville, Alabama; Titusville-Melbourne, Florida; and southern New England. With the exception of the latter, these areas were not pre-existing pools of skilled, professional/technical labour, but were created in the process of setting up defence camp.

Political and strategic factors have played an important role in this shift; especially the opening up of the Pacific Front in the Second World War, and the rise of new Sunbelt politicians such as Johnson, Nixon, Reagan and their congressional counterparts. It is also true that much of the wartime build-up, including new plant construction, took place in the industrial heartlands. Afterwards, it was rapidly dismantled to make way for residential development or reconverted back to producing autos, machine tools and other basic capital goods. The concerted building of new defence-industrial complexes in new regions like the outer Los Angeles area may be attributable in part to a repulsion on the part of defence contractors as a whole, many of whom were former military men, for cosmopolitan, industrial culture as found in the cities stretching for Buffalo to Baltimore, St. Louis to Milwaukee—a repulsion for the adversarial relationship between capital and labour acknowledged in the system of industrial labour relations, so different from that in the military itself, and for the type of urban, democratic political regimes in that region whose posture has included defending the social contracts engineered in the New Deal.[17]

Military contractors enjoyed a hidden incentive to form their own local labor pools in the Defence Department's willingness to pay for relocation costs of personnel recruited from other parts of the country. Not only could these costs be charged to the Pentagon; a normal rate of return could be assessed on them as well. One might conclude that the Pentagon was underwriting and contracting out the business of relocating large proportions of the U.S. workforce *via* this method. Firms found relocating this workforce profitable. While this was clearly not the intent of defence policy, it proved a very effective population redistribution mechanism over the postwar period. In contrast, no other major industrialized nation, none of whom engage in defence innovation at the rate of the U.S., has experienced similar wholesale shifts in population in the postwar period.

The industrial heartland, that region spanning the Appalachians to the Rockies, has been the locus of defence-associated deindustrialization in the 1980s. Previously, dislocation was disproportionately centered on New England and Appalachia in the 1950s and early 1960s, and in the Middle Atlantic states in the 1970s. The core states all experienced net industrial job loss in the period from 1979 to 1984. Together, the Great Lakes states of Michigan, Indiana, Illinois, Ohio and Iowa hosted 5 per cent fewer non-agricultural jobs than in 1979. Net job loss also occurred in the neighbouring states of Kentucky, West Virginia, and Pennsylvania. Only Minnesota and Missouri escaped this negative job growth experience. The losses are all the more striking when one considers

that in the same period, the nation's economy as a whole added jobs at the rate of 4.8 per cent.

This regional experience was not shared by other regions, all of which grew in excess of the national rate, with the exception of the Middle Atlantic rate of 4 per cent (Table 5). Only a few individual states outside the midwest suffered net job loss—Mississippi in the south, and an arc of states running from Nebraska through Wyoming, Montana, Idaho and Oregon to the west. Until the 1980s, the trauma of coping with **absolute** job decline in an era of an expanding labour force had been experienced in only a few isolated instances. In the 1950s, Massachusetts' employment fell by 2.3 per cent and West Virginia's by 12.3 per cent; in the 1970s, New York's job total fell by 1 per cent.[18] Yet in the 1980s, the core industrial states have suffered sizable job shrinkages in just five years.

Diverging regional job growth rates were principally driven by striking differentials in manufacturing job loss. The nation as a whole suffered a decline of more than 8 per cent in manufacturing jobs in the period (Table 6). However, the midwestern rate was more than double that, while the south and west held losses to less than 2.5 per cent. Together, the five states in the industrial heartland lost 925,000 jobs, more than half of the total national net job loss. Put another way, the three states of California, Texas and Florida added 920,000 manufacturing jobs from 1972 to 1984, while the five core states lost 737, 000. Most states east of the Mississippi lost manufacturing jobs, though not nearly as heavily as the industrial core. But there were stunning exceptions: New Hampshire (+5.8 per cent), Florida (+13.2 per cent), and Georgia (+3.2 per cent).

In the west, some states made enormous gains in manufacturing employment in this five-year period: Arizona (+19.6 per cent), Nevada (8.2 per cent), Utah (8.8 per cent), and Colorado (6.5 per cent). Even California, despite heavy losses in some manufacturing sectors, gained more than 44,000 jobs. These manufacturing gains on the part of the former group in a nationally deindustrializing half-decade demonstrate the interactive influence of two trends: (1) the movement of manufacturing jobs toward right-to-work states and (2) the extraordinary concentration of military-related manufacturing in the Sunbelt.

The bulk of the job loss in the industrial core states has been in a tightly interconnected complex of producers' goods and consumer durables. In Illinois alone, five industries—primary metals, fabricated metals, non-electrical machinery, electrical machinery and transportation equipment—accounted for a net loss of more than 325,000 jobs between 1978 and 1985 (Table 7). Among these, the greatest relative losses were to be found in primary metals and non-electrical machinery, which lost 44 per cent and 37 per cent of their net employment respectively in the period.

Declines in manufacturing activity appear to have driven relative differentials in service sector growth between the midwest and the nation (Table 8). With manufacturing losses twice those of the nation, the midwest lagged far behind national growth rates in services, trade and financial sectors. This is modest evidence for the proposition that service industry success is closely tied to the viability of regional manufacturing. Rather than operating as a substitute for manufacturing activity, much service activity is

complementary to it, both through subcontracting arrangements and the multiplier effect.

The dramatic evidence of severe net job loss, a product of both heavy industrial losses and the absence of compensating gains in either manufacturing or other employment sectors, explains the rising phenomenon of outmigration from the states of the industrial core. All the interior regions of the U.S. experienced outmigration in the early 1980s (Table 9). Of these, East North Central states exhibited the highest rate. These five states lost 3 per cent of their 1980 population through outmigration in just four years. In contrast, the Sunbelt regions gained over 3 per cent each in net immigration. A large portion of the differential is accounted for by direct migration streams out of the industrial core to the Sunbelt.

This rather remarkable interregional migration has complemented differentials in rates of natural increase to produce widely divergent population growth rates by region (Table 10). Despite a close-to-average rate of natural increase, the industrial core states actually suffered a net population decline in the period from 1980 through 1985, estimated to be about 40,000 people. Michigan and Ohio together lost more than 125,000 in population, while Indiana, Illinois and Wisconsin posted modest gains.

However, as a group these states lost out stunningly to the Mountain, West South Central and Pacific regions, where growth rates exceeded 10 per cent in the same five years. Indeed, the Sunbelt claimed over 90 per cent of the nation's 12 million in expanded population from 1980 to 1985. Even slow-growth New England posted increases double those of the industrial midwest. The only other states in the nation to lose population in the same period were the flanking states of Iowa (-1.0), Pennsylvania (-0.1) and West Virginia (-0.7).

Not all of this regional recomposition is due to the shift in the federal budget from social spending and infrastructure to military purchases, to foreign arms sales, or to the longer term developmental consequences of military-led innovation. Some is due to the remarkably poor management practices of corporations in non-military sectors throughout the postwar period. A portion is also due to the overvalued dollar, which from 1981 through 1985 heavily favoured imports into domestic markets and cut deeply into overseas markets for both industrial and agricultural exports.[19]

Yet the links are complex. The dollar's appreciation has been linked to high interest rates, which are in part a function of the military-induced federal budget deficit. Furthermore, U.S. arms sales, unlike other exports, are relatively less responsive to fluctuations in exchange rates, in part because of their strategic nature and in part because the United States exercises a virtual monopoly in many arms market segments, buttressed by tied-aid agreements. The dramatic growth of arms sales both abroad and at home has obscured how poorly the rest of the manufacturing sector is doing, stalling a national debate on the causes of and remedies for deindustrialization.

IV. Hypothetical Effects on Canadian-U.S. Trade

These changes in U.S. industrial structure and trade specialization will affect both the level and composition of trade across the U.S.-Canadian border. Briefly, we can anticipate that the relative share of U.S. imports of Canadian origin will stabilize or decline and that the producers' goods component of this trade will grow relatively slowly. In this section, we look at these outcomes hypothetically.

The following discussion assumes that the Canadian manufacturing economy bears a close resemblance in age, sectoral composition and corporate structure to that of the midwestern Great Lakes states in the United States. The bulk of the Canadian manufacturing sector is sited on the northern shores of those lakes and rivers which make up the Canadian portion of the Great Lakes-St. Lawrence Seaway system. The future of this Canadian industrial complex is tightly bound up, as is that of its counterpart across the Lakes, with the continued viability of its producer goods and consumer durables sectors.[20] These, along with resource-based industries like oil and gas, timber, agriculture, are Canada's major export sectors. The United States is the single largest importer from this Canadian manufacturing ensemble.

First of all, we can hypothesize a negative industrial composition effect. Just as in the U.S. midwest, the manufacturing sectors disproportionately favoured by the recent defence buildup are those specializing in large weapons systems (missiles, aircraft, submarines) and the sophisticated high-tech equipment required to operate them. These are not heavily represented in the Canadian manufacturing complex, although Canadian producers are well established in certain segments of telecommunications equipment and aircraft parts production. Rather conspicuously absent, however, are the fast-growing, high-tech sectors supplying electronic equipment, computers, and some scientific instruments to the Pentagon's prime contractors. This represents an historical shift, an asymmetry in the two manufacturing economies, introduced by the quiet industrial policy of the United States, in which substantial amounts of public research and development funds have been invested in domestic companies' efforts.

Thus, if the U.S. defence build-up is to have a positive impact on demand facing Canadian manufacturers, it would have to come in the form of indirect demand—for materials, parts, and machinery. But as we have seen above, the Department of Defence follows a fairly strict Buy America policy which favours domestic firms over foreign competitors, unless performance requirements or haste dictate otherwise.[21] We would expect this policy to be less effective throughout sequential rounds of subcontracting, especially for smaller orders and in cases where a fair number of alternative producers exist. Thus to the extent that secondary impacts are felt by the basic manufacturing complex in Canada, they are most apt to benefit the relatively more competitive, small manufacturers with relatively modestly sized orders. However, these are also sectors which one might expect to be rather highly competitive in both U.S. and other industrial economies, so that derived import demand would be quite broadly diffused.

To the extent that depressed demand for U.S. producers' goods, heavily concentrated in the midwest, can be ascribed to diversion of resources from civilian-oriented sectors to defence-related ones, we may hypothesize a further negative effect on

derived demand for Canadian parts, metals, and machinery workers. However, this diversion might also operate in the opposite direction, especially in the long term. Since the Canadian engineering and research establishments have not been as heavily oriented toward defense priorities as in the U.S., we might hypothesize that they have been dedicated to the commercialization of various innovations and to the improvement of civilian-oriented production processes. This, as we noted above, is what Japanese firms have apparently done with their manpower and with many of the inventions emerging from the U.S. defence effort. As a result, Canadian performance in industries like basic steel, fabricated metals, and machine tools could be expected to be superior to that of the same industries in the United States.

Finally, the geographical shift of production away from the industrial heartland and toward a "defence perimeter" in the United States could be expected to play a negative role in relative growth rates of Canadian imports *versus* those from overseas, Asia in particular. Hypothetically, the demand for both producers' goods, at least those like steel with substantial transportation costs, and for consumer goods will diminish with distance, especially where dependent on land-based modes of transportation. With the dramatic divergence in U.S. regional growth rates in this decade, attributable in large part to the defence build-up, induced demand for goods and services from income expenditure has grown least in that region of the United States with closest geographical proximity to the Canadian manufacturing complex. Thus, we would expect that the relatively depressed midwestern industrial economy would drag down a portion of the nearby Canadian complex with it.

V. Evidence from Recent Trade Patterns

Theoretically, then, we could expect that the net Canadian/U.S. trade impact of the United States' defence build-up would not be as positive as would the same expenditure on civilian-oriented activities, because of adverse industrial and geographical restructuring and Buy America practices. One way of testing this outcome is to investigate the performance of defence-related sectors *vis-à-vis* civilian-oriented sectors in the composition of Canada's exports to the United States. What follows is a first attempt to do so, using somewhat imperfect data and categories.[22] The period chosen for examination is that from 1981, when the effects of the defence build-up might be expected to have taken hold, to 1985, the most recent year for which data are available.

The evidence does support the contention that producers' goods and consumer durables are a major and growing component in Canada's export trade with the United States. Among major exporting sectors, those in the metals, machinery and transportation equipment sectors increased their share of exports from 28 per cent to 40 per cent from 1981 to 1985. But relatively speaking, the greatest gains in trade between the United States and Canada have not taken place in the defence-related and high-tech sectors (Table 11). Sectors with a moderate to strong defence orientation barely held even in export share between 1981 and 1986, at 6 per cent. In contrast, the major non-defence-

related producer and consumer durables sectors increased their share from 21 per cent to 33 per cent.

If we define defence-dependent as those U.S. industries with 40 per cent or more of their output in 1982 directly or indirectly sold to the Department of Defense, there are only two significant Canadian counterparts exporting to the United States telecommunications and aircraft, including parts. Both sectors increased their exports to the United States in the period from 1981 to 1985 substantially, by 99 per cent and 43 per cent respectively in (current dollars). However, both lagged behind the export growth rates posted by the producer and consumer durables sectors as a whole (11.2 per cent).

Of the two, telecommunications was the better export growth performer, but its share of U.S. telecommunications imports fell in the period. Thus Canada does not appear to be well poised to increase its market share of dramatically-growing U.S. demand in this category, whether defence-originated or not.[23] The aircraft, spacecraft and parts industry, on the other hand, is a relatively larger exporter to the United States and accounts for more than one quarter of U.S. imports in that category. However, although it increased its market share slightly, its growth rate was relatively low, a function of the relatively modest growth of U.S. aircraft and spacecraft imports. One can speculate that the bulk of these imports are in the form of parts, particularly those destined for commercial aircraft, rather than finished craft for defence purposes.

The difference in Canadian export growth rates between these two sectors is circumstantial evidence for the proposition that subcontracting sectors in Canada will fare better than weapons assembly or major component sectors. Both of these sectors have grown dramatically in both demand and output within the United States in the 1980s. Yet the aircraft/missile/spacecraft complex appears to have been better protected by Buy America practices than has telecommunications, a subcontracting sector. This conclusion is also supported by the resilience of the positive U.S. trade balance in the former throughout the 1980s, while its position in the electronics and communications equipment categories has deteriorated rapidly and was negative by 1984.[24]

How has high-tech trade fared in general between the United States and Canada? The Department of Commerce concluded in 1984 that high tech formed "only a very small share of goods moving in either direction." Furthermore, the balance is substantially in the favour of the United States. Some 17 per cent of U.S. exports to Canada are high tech, while only 7 per cent of U.S. imports from Canada fall into this category. Again, the postwar role of the cold war build-up in stimulating U.S. high-tech industry explains these bilateral differentials.[25]

A second group of industries can be defined as defence-related those which sold between 5 per cent and 40 per cent of their output directly or indirectly to the Department of Defence in 1982. Major corresponding Canadian export sectors in this category include non-electrical machine parts, special industrial machinery, screw machine products, aluminum and steel flat-rolled products. All of these sectors increased the dollar value of their exports to the United States in the period from 1981 to 1985. However, three (machine parts, aluminum and steel) had extraordinarily poor growth rates relative to the producer/consumer durables complex as a whole. The other two grew relatively more

rapidly than Canadian exports as a whole, but still less rapidly than the non-military-related sectors described below.

The disproportionate share of growth in manufactured exports to the United States has been in the Canadian auto-related industries. Motor vehicles, engines and parts exports grew 130 per cent (in current dollars) in the four years from 1981 to 1985, far above any of the other sectors in this complex. By the latter year, they accounted for almost 33 per cent of Canadian exports to the United States and for 40 per cent of U.S. motor vehicle imports.

When placed in the context of bilateral trade, it is clear that the producers' goods industries in Canada have not been able to make the great inroads on the trade balance between the two countries that motor vehicles have. By the end of 1984, the United States still maintained a large positive capital goods trade balance with Canada—US $5 billion, down from—US $5.6 billion in 1980. In contrast, on the automotive front the United States plummeted from a small US $0.2-billion surplus in 1980 to US $7.5-billion deficit in 1984.[26] Capital goods export gains, in other words, whether high or low tech, are not as easily achieved by Canada even with favourable currency rates.

The only other sizable sector for which data was readily available, and which is not defined as defence-related by the Bureau of Industrial Economics, is office machine parts. This sector also posted export gains in excess of any of the defence-related industries. However, it fared the worst among all sectors in loss of market share, dropping to 8 per cent from 14 per cent in four years.

The striking finding is that Canadian non-defense-related sectors performed unequivocally better than all the defence-related industries in export growth rates in the period from 1981 through 1985. Since this analysis has been purely comparative, examining changes in the Canadian composition of exports to the United States and their relative market shares of U.S. imports, we have not been able to show conclusively that the U.S. defence build-up has not had a positive impact on Canadian exports. Imports into the United States from Canada grew by 48 per cent in the four-year period in current dollars, in large part a function of exchange rate differentials. However, one would assume that the dramatic shift toward defence-related sectors in the United States would have resulted in more than proportional gains of similar Canadian sectors in exports across the border. Yet the evidence shows the opposite.

Why should non-defence-related industries outperform defence-related ones? Surely one answer is the accumulated effect of the 1964 auto pact *versus* the Buy America practices of the Defence Department. However, the rather lacklustre performance of the mixed civilian/defence sectors, like machinery and parts, must also be attributed to the changing nature of military-oriented manufacturing with its increased reliance upon high tech rather than machinery and material inputs. In this sphere, Canadian producers lose out the same way that midwestern U.S. manufacturers do. Furthermore, the evidence does not suggest that Canada, without a huge commitment to defence-led innovation, has been able to do what Japan has—to successfully take defence-generated

innovations and turn them into better machine tools, industrial machinery and new generation high-tech equipment.

What would happen if and when the exchange rate between the United States and Canada returned to more historic levels? If it were to do so, then the Canadian manufacturing economy would undoubtedly look much more like the U.S. midwest in the current period. Capacity utilization in non-military producer goods and consumer durables has clearly shifted in Canada's favour during the 1980s, obscuring the relatively depressing effect of the shift in the U.S. federal government budget from civilian to military priorities. If the Canadian dollar were to appreciate considerably, this fact would become clearer in rising Canadian manufacturing unemployment rates.

The evidence offered here does not permit us to test the relative contribution of factors like trade liberalization or barriers to trade to the relative performance of defence-related versus non-defence manufacturing sectors. One might be tempted to ascribe all of the compositional change within producer and consumer durables to the auto pact on one hand and the Buy America policy on the other. An appropriate Canadian response, therefore, might be to argue for trade liberalization in defence-related product lines. Alternatively, one might argue for more Canadian/U.S. joint partnerships like that recently formed between Honeywell and a Japanese computer firm to win a Pentagon computer contract.

However, in my view it would be a serious mistake to assume that relative barriers to trade are the major cause of this imbalance. Within the United States, where no such barriers exist, the producer goods industries with modest levels of defence involvement have been extraordinarily hard hit by a combination of lagging demand, resource diversion and import penetration. Many producer goods imports have succeeded not because of price but quality considerations, to which firms in "non-defence-oriented" countries like Japan and Germany have committed themselves while the U.S. engineering establishment has been preoccupied with Star Wars and its predecessors.

Many depressed industrial states have tried to respond to defence-related economic losses by heavily criticizing the "Pentagon tilt" toward the Sunbelt and by setting up state government offices to try to help their business people to win procurement contracts.[27] None of these efforts has had much visible impact on the federal governments' regional distribution of contracts, which still flow heavily toward the newer defence-oriented agglomerations like southern California. It is unlikely that Canada would have any greater success in trying to liberalize defence-related trade between the two countries. The more powerful approach, in my view, would be a joint U.S./Canadian effort to understand the causes of relatively poor performance of both countries' products in international markets for consumer durables and non-military producers' goods. What both countries' economies need is a longer term vision of where each is going developmentally. A more productive partnership might emerge if the debate were to transcend the free trade/protectionism polarity and place mutual problems of adjustment, stability and development on the agenda.

Notes

1. Kenneth Flamm, the Brookings Institution, Paper presented at the Conference on Strategic Computing, University of California, Santa Cruz, March 1985. Section I and II of this paper are based on my article, "Military Spending and the U.S. Economy," *World Policy Journal*, Vol. III, No. 3, 1986: 495-516.

2. "Military Research and the Economy: Burden or Benefit?" Center for Defense Information, *The Defense Monitor* Vol. XIV, No. 1, 1985, Washington, DC.

3. See *Our Own Worst Enemy: the Impact of Military Production on the Upper South*, New Market: Highlander Research and Education Center, 1983, for the political background on the current build-up. Even the figures understate the true significance of military spending for the economy, since they do not include commitments such as the Department of Energy's nuclear warhead and waste activities, the defence-related portions of the National Aeronautical and Space Administration, and the activities of the National Guard, Coast Guard, the Federal Emergency Agency, and others. See Randy Shutt, *The Military in Your Backyard: A Workbook for Determining, the Impact of Military Spending in Your Community*. Mountain View, Mid-Peninsula Conversion Project, 1984.

4. Michael Boretsky, "Trends in U.S. Technology: A Political 1975: Economist's View," *American Scientist*. January/February, 1981; The Boston Study Group, *The Price of Defense*, San Francisco: W.H. Freeman, 1982:258; Jacques Ganaler, *The Defense Industry*, Cambridge, Mass: MIT Press: 208-9.

5. Norman Fieleke, "The Foreign Trade Deficit and American Industry." *New England Economic Review*, The Federal Reserve Bank of Boston, July/August, 1985, 43-52.

6. For treatment of this issue, see Michael Klare, *American Arms Supermarket*. Arms purchases have consumed a growing share of many Third World countries' gross national product. However, in 1984, their purchases in absolute terms began to fall, as the debt crisis and economic stagnation set in. Arms exports from the U.S. were about $31 billion in 1983 and fell somewhat in 1984.

7. See Robin Bloch, "Advanced Composite Materials: An Industry Study." MCP Professional Report, University of California, Berkeley, 1984: 23-4.

8. David Henry, "Defense Spending: A Growth Market for Industry." *U.S. Industrial Outlook*, 1983: XXXIX-XLVII.

9. Richard P. Oliver, "Employment Effects of Reduced Defense Spending", *Monthly Labor Review*, No. 94 (December 1971): Table 4.

10. In a large data-based study of high-tech industries in the United States in the 1970s, we found that about 47 per cent of all high-tech manufacturing employment is found in sectors that are defence-dependent as defined by the Bureau of Industrial Economics. See Ann Markusen and Robin Block, "Defensive Cities: Military Spending, High Technology and Human Settlements." In Manuel Castells, ed., *High Technology, Space, and Society*. Volume 28, Urban Affairs Annual Reviews, Beverly Hills: Sage, 1985.

11. For an extensive discussion of high-tech industries, their composition and growth patterns, see Ann Markusen, Peter Hall, and Amy Glasmeier, *High Tech America: The What, How, Where, and Why of the Sunrise Industries*. Boston: Allen & Unwin, 1986.

12. "Factories Are Plugging Along," *Business Week*, December 30, 1985: 45; Fieleke, (fn.5): Table 2.

13. The regional distribution of these industries is analyzed in Markusen, Hall and Glassmeier, (fn. 11). We found that per capita defence spending was consistently a significant positive determinant of high-tech job growth and plant location in the United States, even in the build-down period of the 1970s.

14. Jay Stein, "U.S. Defense Spending: Implications for Economic Development Planning," Working Paper, Graduate City Planning Program, Georgia Institute of Technology, 1985.

15. Brendan OhUallachain, "Some Regional Implications of Recent Growth in the American Military Industrial Complex" Working Paper, Department of Geography, Northwestern University, 1986.

16. See Ann Markusen "Defense Spending and the Geography of High Tech Industries," in John Rees, ed., *Technology, Regions and Policy*. New York: Praeger, 1986, for an extended discussion of military manufacturing location.

17. See James Fallows, *National Defense*, New York: Vintage, 1982, for a description of how military manpower is structured in contrast to private labor markets.

18. For an extended discussion of postwar employment growth by state and region, see Ann Markusen, *Region Building: The Economic and Political Origins of Regionalism*. Totowa, N.J.: Rowan and Allenheld, 1986: Chapter 5.

19. See the discussion of the macroeconomic and managerial issues affecting recent steel industry performance in Ann Markusen, *Steel and Southeast Chicago: Reasons and Opportunities for Industrial Renewal*, Northwestern University, Center for Urban Affairs and Policy Research, November 1985, Chapter 8. See also the author's *Profit Cycles, Oligopoly and Regional Development* Cambridge, Mass.: MIT Press, 1985.

20. The same five sectors focused upon above in the discussion of the midwestern economy play an equally dominant role in Canadian Great Lakes manufacturing. Nearly one half of Ontario's manufacturing value added and employment is accounted for by these five. Pierre-Paul Proulx, *A Review of Studies of Sectoral Impacts of Bilateral and Multilateral Trade Liberalization on Canada*. Department of Economics, University of Montreal, mimeo, September 1986.

21. The aircraft and telecommunications industries are covered by agreements similar to the auto pact. Yet informal Buy America practices work against Canadian suppliers. However, there are cases where large U.S. defence contractors operate plants in Canada. An example is Pratt and Whitney's plant near Montreal. The author has not had time to pursue the important question of how the Pentagon treats foreign subsidiaries of U.S. firms. A small portion of defence research funds have also been committed to Canadian universities.

22. Since industries' relative defence-dependency was only available by SIC code, and since it was preferable to work at the 3- and 4-digit levels, small differences in the translation of schedule A imports into SIC code designations had to be tolerated. In addition, the most readily available data which met the requirements for timeliness, a comparable time series, and appropriate level of disaggregation, were presented only for the top thirty-five exporting industries. Thus, some of the smaller industries which may have experienced positive demand feedback effects have been excluded.

23. On the other hand, Canada can expect a relatively stable market share. Furthermore, Canadian telecommunications exports to the United States have exceeded imports from the United States since 1981.

24. U.S. Department of Commerce, International Trade Administration, 1985, *U.S. Trade Performance in 1984 and Outlook*. Washington, DC; GPO: 11-18.

25. U.S. Department of Commerce, International Trade Administration, 1984, *U.S. Trade Performance in 1983 and Outlook*. Washington, DC; GPO: 25.

26. Fieleke, 1985: 47.

27. See for instance the Northeast-Midwest Institute, 1977, *A Case of Inequality: Regional Patterns in Defense Expenditures, 1950-1977*, and Jacqueline Mazza and Dale Wilkinson, 1980, *The Unprotected Flank: Regional and Strategic Imbalances in Defense Spending Patterns*. Washington, DC: Northeast-Midwest Institute.

Table 1
Department of Defence Shares of Selected Industry Output, 1979-87

Code	Title	Defence share of output			Defence output growth
		1979	1982	1987	1982/87
		(%)	(%)	(%)	(%)
3795	Tanks and tank components	78.1	93.8	95.0	47.2
3483	Ammunition	95.1	90.9	93.2	55.6
3489	Ordnance	85.1	79.7	81.2	35.3
3761	Complete missiles	71.0	67.5	79.4	64.4
3731	Shipbuilding and repair	47.9	61.5	62.1	24.1
3662	Radio and TV communication	44.8	58.0	62.5	54.2
3724, 64	Aircraft and missile engines	42.3	53.5	56.1	32.9
3728, 69	Aircraft and missile equipment	43.4	41.2	44.2	34.9
3721	Aircraft	35.0	40.4	46.1	58.7
383	Optical instruments	21.6	28.0	30.7	38.0
3811	Engineering instruments	23.5	27.7	33.6	59.9
3676-9	Electronic components	12.0	17.0	19.8	49.3
3674	Semiconductors	9.5	12.5	12.5	51.4
3361	Aluminum foundries (castings)	7.9	9.1	11.2	58.5
3334	Aluminum production	5.8	7.5	9.0	51.4
3469	Metal stampings	5.8	7.3	9.1	60.3
3671-3	Electron tubes	8.3	7.3	11.5	105.3
3573	Computers	3.6	7.1	12.7	141.0
345	Screw machine products	5.6	6.9	8.6	57.5
3462	Iron and steel forgings	7.9	6.9	7.6	31.4
3541	Machine tools—cutting	6.1	6.2	7.5	54.4
3544-5	Special dies and tools	4.9	6.0	7.5	45.4
3499	Fabricated metal products	5.0	5.6	6.8	53.4
281	Chemicals	5.5	5.6	7.1	53.3
3312	Blast furnace steel mills	4.5	5.6	6.7	45.6
3313	Electrometallurgical products	4.9	5.4	6.3	26.7
3542	Machine tools forming	5.0	4.8	6.3	70.0
332	Iron and steel foundries	3.9	4.5	5.2	45.1

Source: Henry, "Defense Spending," *U.S. Industrial Outlook*, 1983.

Table 2
U.S. Trade by Major Sector, 1980-1984 ($ billions)

Major Sector	1980	1984
Foods, feeds and beverages		
Exports	35.5	30.9
Imports	18.1	21.0
Balance	17.2	10.5
Industrial supplies and materials		
Exports	70.2	61.5
Imports	129.2	122.1
Balance	-59.0	-60.6
Capital goods, not automotive		
Exports	72.6	72.0
Imports	30.5	59.8
Balance	42.1	12.2
Automotive vehicles, parts, engines		
Exports	16.2	20.9
Imports	28.0	55.1
Balance	-11.8	-34.3
Consumer goods, not food or auto		
Exports	16.2	13.3
Imports	34.4	60.0
Balance	-18.2	-46.6
Military-type goods		
Exports	10.2	24.4
Imports	4.6	7.7
Balance	5.6	16.7
All Categories		
Exports	220.8	223.6
Imports	244.9	325.7
Balance	-24.1	-102.2

Source: Norman Fieleke, "The Foreign Trade Deficit and American Industry." *New England Economic Review*. The Federal Reserve Bank of Boston, July/August, 1985: 43-52.

Table 3
Relative Regional per Capita Military Receipts, 1983

Region	Total Receipts ($ bills)	Procurement Ratio*	Personnel Ratio*	Research Ratio*	Total Ratio
New England	18.21	2.06	0.74	1.57	1.44
Mid-Atlantic	24.18	0.83	0.44	0.61	0.64
East North Central	18.02	0.45	0.44	0.14	0.43
West North Central	15.03	1.07	0.60	0.91	0.85
South Atlantic	53.38	0.97	1.67	2.27	1.35
East South Central	10.05	0.53	0.84	0.41	0.66
West South Central	23.39	0.81	1.08	0.21	0.89
Mountain	18.40	0.96	2.08	1.14	1.47
Pacific	56.69	1.85	1.44	1.75	1.66

Source: Jay Stein, "U.S. Defense Spending: Implications for Economic Development Planning," Working Paper, Georgia Institute of Technology, City Planning Program, 1985: Table 3.

* The ratios represent the regions' per capita receipts divided by the national per capita expenditure for 1983.

Table 4
Highest and Lowest Ranking States in Military Shipments, 1983

Rank	Top States	Military Shipments Location Quotient	Rank	Bottom States	Military Shipments Location Quotient
1	California	2.62	50	Arkansas	0.001
2	Connecticut	2.49	49	West Virginia	0.02
3	Missouri	2.49	48	Idaho	0.06
4	Arizona	2.30	47	North Carolina	0.07
5	Utah	2.10	46	South Carolina	0.08
6	Maryland	1.97	45	Kentucky	0.10
7	New Hampshire	1.88	44	Nebraska	0.12
8	Kansas	1.85	43	Alabama	0.26
9	Massachusetts	1.71	42	Montana	0.27
10	Vermont	1.66	41	Wisconsin	0.28
11	Virginia	1.55	40	Tennessee	0.30
12	Rhode Island	1.35	39	Oregon	0.33
13	Florida	1.25	38	Iowa	0.33
14	Colorado	1.23	37	Delaware	0.43
15	Texas	1.17	36	Michigan	0.45

Source: Brandan OhUallachain, "Some Implications of Recent Growth in the American Military-Industrial Complex." Working Paper, Northwestern University, Department of Geography, 1986, Table 1, p. 4. Data are from the Department of Commerce's *Current Industry Reports* and were weighted by 1982 employment levels to reflect the lag between production and final delivery.

Table 5
Regional Change in Non-agricultural Employment: 1979-1984 (in thousands)

Region and State	1979		1984		Change, 1979-1984	
	Number	Percentage of U.S. Total	Number	Percentage of U.S. Total	Number	Percentage
New England	5,393.5	6.0	5,890.1	6.2	496.6	9.2
Mid-Atlantic	16,960.7	19.8	17,625.0	18.6	664.3	3.9
South	26,622.4	29.4	29,246.1	30.9	2,623.7	9.9
West	21,351.2	23.6	22,838.7	24.1	1,487.5	7.0
Midwest	20,100.3	22.2	19,186.9	20.2	-913.4	-4.5
U.S. Total	90,428.1	100.0	94,786.8	100.0	4,258.7	4.8

Sources: U.S. Department of Labor, Bureau of Labor Statistics. *Employment, Hours, and Earnings, States and Areas, 1939-82*. Washington, D.C. (1984); *Employment and Earnings*. Washington, D.C. (1984, May 1985).

Table 6
Regional Change in Manufacturing Employment: 1979-1984 (in thousands)

Region and State	1979		1984		Change, 1979-1984	
	Number	Percentage of U.S. Total	Number	Percentage of U.S. Total	Number	Percentage
New England	1,522.9	7.2	1,497.5	7.7	-25.4	-1.7
Mid-Atlantic	3,995.9	19.0	3,468.0	17.9	-527.9	-13.2
South	5,822.9	27.6	5,680.7	29.4	-142.2	-2.4
West	3,945.7	18.7	3,905.2	20.2	-40.5	-1.0
Midwest	5,780.0	27.4	4,780.1	24.7	-999.9	-17.3
U.S. Total	21,067.4	100.0	19,331.5	100.0	-1,735.9	-8.2

Sources: U.S. Department of Labor, Bureau of Labor Statistics. *Employment, Hours, and Earnings, States and Areas, 1939-82*. Washington, D.C. (1984); *Employment and Earnings*. Washington, D.C. (1984, May 1985).

Table 7
Illinois Job Change in Five Basic Industrial Sectors, 1978-1985*

Sector/SIC	Jobs 1978 (000)	Jobs 1985 (000)	Job Loss 1978-85 (000)	Percentage Loss 1978-85
33 Primary metals	98.2	55.0	-43.2	-44
34 Fabricated metals	147.0	110.7	-36.3	-25
35 Non-electrical machinery	228.1	143.7	-84.4	-37
36 Electrical machinery	166.7	126.1	-40.6	-24
37 Transportation equipment	54.2	39.0	-15.2	-28
Manufacturing Total	1276.0	950.7	-325.3	-26
Non-agricultural employment Total	4788.8	4707.1	-81.7	-2

Source: Bureau of Labor Statistics

* 1985 figures are for September 1985.

Table 8
Growth Rates in Midwest and Illinois Population and Employment, 1979-1984.

	United States	Midwest	Illinois
Population*	+4.2%	0.0	+0.7
Employment, non-agricultural	+4.8	-4.5	-5.1
Employment in manufacturing	-8.2	-17.3	-22.5
Employment in service	+21.4	+13.5	+13.5
Employment in wholesale & retail trade	+9.1	0.0	+0.2
Finance, real estate, insurance	+14.6	+6.7	+7.7

Source: Northeast-Midwest Congressional Coalition, 1985.

* Population figures are for 1980-84. All others are for 1979-1984.

Table 9
Components of population growth rates by region, 1980-1984

Region	Total Growth	Natural Increase	Net Migration
New England	1.8	1.8	0.0
East North Central	-0.2	2.8	-3.0
West North Central	1.9	3.0	-1.1
Mid-Atlantic	1.0	1.7	-0.7
South Atlantic	6.7	2.5	4.2
East South Central	2.5	2.8	-0.3
West South Central	9.9	4.7	5.2
Mountain	10.4	5.6	4.8
Pacific	7.5	4.2	3.3

Source: Current Population Reports, Series P-25, No. 970.

Table 10
Regional Population Growth Differentials, 1980-85
(Numbers in thousands. Includes Armed Forces residing in each State.)

Region, Division and State	April 1, 1980 (census)	July 1, 1985 (provisional)	Change, 1980-85 Number	Change, 1980-85 Percentage
United States	226,546	238,740	12,194	5.4
Northeast				
New England	12,348	12,660	311	2.5
Middle Atlantic	36,787	37,199	412	1.1
Midwest				
East North Central	41,682	41,642	-40	-0.1
West North Central	17,183	17,555	371	2.2
South				
South Atlantic	36,959	40,227	3,268	8.8
East South Central	14,666	15,122	455	3.1
West South Central	23,747	26,510	2,763	11.6
West				
Mountain	11,373	12,789	1,416	12.5
Pacific	31,800	35,037	3,237	10.2
East North Central				
Ohio	10,798	10,744	-53	-0.5
Indiana	5,490	5,499	9	0.2
Illinois	11,427	11,535	108	0.9
Michigan	9,262	9,088	-174	-1.9
Wisconsin	4,706	4,775	70	1.5

Source: U.S. Bureau of the Census.

Table 11
Selected Metals, Machinery and Transportation Equipment Export from Canada to the U.S., 1981-1985 ($ millions)

Industry	Exports to United States 1981	1985	Export growth rate	Share of U.S. Imports 1981	1985	Growth index[a]
Defence-dependent:						
Telecommunications	$297	592	99	9	8	88
Air, spacecraft	722	1,029	43	28	29	38
Defence-related:						
Non-electrical machine parts	277	398	44	--	--	39
Spec industry machinery	191	398	108	16	16	96
Aluminum, alloys	798	900	13	--	--	23
Screw machine products	320	601	88	--	--	79
Steel plate, sheet	297	387	30	9	8	27
Non-defence-related:						
Motor vehicles, parts[b]	9,072	20,877	130	31	35	116
Engines, parts	812	1,875	131	29	29	116
Office machine parts	204	444	117	14	8	104
Total, selected machinery, metals, transportation equip.	12,988	27,501	112	--	--	--

Source: U.S. Department of Commerce, International Trade Administration 1986. *1985 U.S. Foreign Trade Highlights*. Washington, D.C.: Government Printing Office.

a Industry export growth rates divided by export growth rate for machinery, metals and transportation equipment.

b Excludes bus and truck trailers and chassis.

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